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No.

Supreme Court, U.S.
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In the

Supreme Court of the United States

OCTOBER TERM 1987

RICHARD ROTHENBERG,

Petitioner,

v.

THE AMALGAMATED SUGAR COMPANY, LLC CORPORATION and LN PARTNERSHIP,

Plaintiffs-Respondents,

and

NL INDUSTRIES, INC., ROBERT A. BICKS, NICHOLAS F. BRADY, MAURICE F. GRANVILLE, WILLIAM A. MARQUARD, JAMES F. MATHIS, THEODORE C. ROGERS, IAN M. ROSS, HERMAN J. SCHMIDT, ROBERT G. SCHWARTZ, DONALD V. SEIBERT, ELEANOR B. SHELDON and THOMAS P. STAFFORD,

Defendants-Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

Questions Presented for Review

1. Whether, under the "relitigation exception" of 28 U.S.C. Section 2283, the district court should have abstained from enjoining prosecution of New Jersey state class action by shareholder of New Jersey corporation who sought to sustain validity of New Jersey corporation's Preferred Shares Rights Plan under New Jersey law and to enforce the right of himself and the class to receive the Rights dividend which had been duly declared by the New Jersey corporation pursuant to its Rights Plan and who was not a party to the first litigation in the district court between plaintiffs-respondents and defendants-respondents?

2. Whether plaintiffs in the district court waived their right to enjoin the New Jersey state class action upon the ground of *res judicata* pursuant to the "relitigation exception" of 28 U.S.C. Section 2283 where plaintiffs first litigated and lost in the New Jersey Superior Court a motion for summary judgment upon the ground of *res judicata* and thereafter the New Jersey Appellate Division denied plaintiffs' motion for leave to appeal?

3. (a) Whether consent judgment entered on August 14, 1987, in the first litigation in the district court declaring that New Jersey corporation's Rights Plan is invalid under New Jersey law is *res judicata* as against petitioner and the other shareholders who owned corporation's stock as of the record date (July 10, 1986) for receiving the Rights dividend and who were not parties to the first litigation in the district court?

(b) Whether, further, the corporation's discontinuance of its appeal to the Court of Appeals from an adverse preliminary injunction decision and the corporation's consent to entry of the final judgment against it (after plaintiffs acquired 51% of the corporation's common stock, together with the *immediate* right to name a majority of the corporation's directors, and agreed to substantial bene-

fits for the corporation's management and the preservation of management's jobs) rendered the corporation an inadequate representative of the class for purposes of *res judicata*?

(c) Whether, in any event, the prior consent federal judgment that plaintiffs obtained against the corporation was void for lack of subject matter jurisdiction because of mootness in that at the time of entry of judgment plaintiffs were in control of the corporation in that plaintiffs had obtained over 51% of the corporation's stock and the *immediate* right to name a majority of the corporation's directors?

List of Parties

All formal parties are listed in the caption of the case in this Court.

Not listed as parties are the thousands of persons who were shareholders of NL Industries, Inc. ("NL") as of the record date (July 10, 1986) for receiving the Rights dividend that had been duly declared by NL pursuant to its Rights Plan. As a result of the decisions of the courts below, these persons have been deprived of their property, namely, their right to receive the duly declared Rights dividend.

TABLE OF CONTENTS

Opinions Below 1

Jurisdiction 2

Statutory Provisions Involved 2

Statement of the Case 2

A. Preliminary Statement 2

B. Procedural History of the Case 3

C. Harold C. Simmons—The Notorious Corporate Raider 7

D. Simmons Intentionally Triggers the Distribution of the Preferred Rights In Order To Serve His Own Purposes 8

E. The Instant Litigation Is Part of Simmons' Persistent and Continuing Efforts to Evade Having the New Jersey Courts Decide the Validity of NL's Preferred Shares Rights Plan Under New Jersey Law 9

F. NL Agrees with Simmons to Enter the Judgment Declaring NL's Rights Plan Invalid 11

REASONS FOR GRANTING THE WRIT

I. The within federal injunction against the prosecution in the New Jersey state courts of the instant class action to determine the validity under New Jersey law of the New Jersey corporation's Preferred Shares Rights Plan and to enforce the right of the class to receive the duly declared Rights dividend is contrary to established principles of abstention and, moreover, federalizes state corporation law 13

II. In its opinion herein, the Court of Appeals, contrary to the sound administration of justice, affirmatively and expressly encourages a state court defendant to take "two bites at the apple," that is, to litigate the question of *res judicata* two times successively in two different courts—first in state court and then, if unsuccessful there, in federal court under Section 2283 17

III. The federal injunction herein is contrary to the established federal rule of *res judicata* that a judgment against a corporation is not *res judicata* against the corporation's shareholders, particularly where, as here, many, if not most, of the class had sold their stock in the corporation before entry of the consent judgment 20

IV. —The prior consent judgment against the corporation is not *res judicata* against the class for the further reason that under established law the corporation's withdrawal of its appeal and consent to entry of judgment against it rendered the corporation an inadequate representative of the class 23

V. The prior consent judgment is not *res judicata* against the class for the still further reason that under established law the controversy between Amalgamated and the corporation had become moot when Amalgamated obtained 51% of the corporation's stock and the immediate right to name a majority of the corporation's directors and thus acquired control over the corporation. 24

Conclusion 25

APPENDIX A—Opinion of the District Court in *The Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F. Supp. 1229 (S.D.N.Y. 1986)..... A1

APPENDIX B—Oral Opinion of the District Court in *The Amalgamated Sugar Co. v. NL Industries, Inc.* B1

APPENDIX C—Opinion of the Second Circuit in *Rothenberg v. The Amalgamated Sugar Company, Inc.*, 825 F.2d 634 (2d Cir. 1987) C1

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Burford v. Sun Oil Co., 319 U.S. 315 (1943) 14

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CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987) 16

Delta Airlines Inc. v. McCoy Restaurants Inc., 708 F.2d 582 (11th Cir. 1983) 24

Dudley v. Smith, 504 F.2d 979 (5th Cir. 1974) 21

First Alabama Bank v. Parsons Steel, Inc., 747 F.2d 1367 (11th Cir. 1984), *rev'd on other grounds*, 106 S. Ct. 768 (1986) 15, 18, 19

Golden v. Zwickler, 394 U.S. 103 (1969) 25

Gonzales v. Cassidy, 474 F.2d 67 (5th Cir. 1973) 23

Hunt v. Liberty Lobby, Inc., 707 F.2d 1493 (D.C. Cir. 1983) 20

In re Teltronics Services, Inc., 762 F.2d 185 (2d Cir. 1985) 21

Kern v. Hettinger, 303 F.2d 333 (2d Cir. 1962) 20

Memphis Light, Gas & Water Division v. Craft, 436 U.S. 1 (1978) 25

Mitchum v. Foster, 407 U.S. 238 (1972) 14

Moran v. Household Int'l, Inc., 500 A2d 1346 (Del. 1985 11

NL Industries, Inc. v. Simmons, et al., Docket No. 86-C-128 (N.J. Sup. Ct. 1986) 7

Pennzoil Co. v. Texaco, Inc., 107 S. Ct. 1519 (1987). 14

PRC Harris, Inc. v. Boeing Co., 700 F.2d 894 (2d Cir. 1983 20

Ritchie v. Landau, 475 F.2d 151 (2d Cir. 1973) 21

Rothenberg v. The Amalgamated Sugar Co., No. C-86-0188 (N.J. Sup. Ct. Ch. Div.) ..... *passim*

The Amalgamated Sugar Co. v. NL Industries, Inc., 644 F. Supp. 1229 (S.D.N.Y. 1986)..... 1, 4

Younger v. Harris, 401 U.S. 37 (1971)..... 14

Zenith Radio Corp. v. Hazeltine Research Co., 395 U.S. 100 (1969) 21, 22

Constitutional Provisions:

U.S. Const., Art. III 24

Statutes Cited:

28 U.S.C. §1254(1) 2

28 U.S.C. §2283 ..... *passim*

Other Authorities:

1B Moore's, *Federal Practice*, ¶0.411[11] 21

6A Moore's, *Federal Practice*, ¶57.13..... 25

18 Wright, Miller & Cooper, Federal Practice & Procedure, §4460..... 21

Wright, *Law of Federal Courts* (Hornbook 4th ed. 1983) 15

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Defendants-Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Opinions Below

The opinion of the district court in the first litigation between plaintiffs-respondents and defendants-respondents, in which the district court held NL's Preferred Stock Rights Plan to be invalid under New Jersey law, is reported in *The Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F. Supp. 1229 (S.D.N.Y. 1986) and is appended hereto as Appendix A.

The oral opinion of the district court in this litigation enjoining petitioner Rothenberg from prosecuting a class action in the New Jersey state courts to declare NL's Rights Plan valid and to enforce the right of himself and

the class to receive the Rights dividend that had been duly declared by NL is unreported and is appended hereto as Appendix B. The Second Circuit's opinion in this litigation, affirming the district court, is reported at 825 F.2d 634 and is appended hereto as Appendix C.

Jurisdiction

The court below issued its opinion on July 28, 1987. This court has jurisdiction pursuant to 28 U.S.C. §1254(1).

Statutory Provisions Involved

Section 2283 of 28 U.S.C. provides:

> "Stay of State court proceedings
>
> "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

Statement of the Case

A. Preliminary Statement

By order dated March 23, 1987 (A•584), the district court granted the application of plaintiff-respondent, The Amalgamated Sugar Company ("Amalgamated"), and its corporate successor Valhi Inc. for a permanent injunction enjoining appellant, Richard Rothenberg, from seeking in his action in New Jersey Superior Court (*Rothenberg v. The Amalgamated Sugar Co.*, No. C-86-0188 (N.J. Super. Ct. Ch. Div.)) or in any other actions relief premised upon the validity of the Preferred Share Purchase Rights Plan of defendant-respondent, NL, a New Jersey corporation (A236). The district court granted the order for the reasons previously set forth on the record on March 18, 1987 (Appendix A, *infra*).

• References to "A" are to the Joint Appendix.

B. Procedural History of the Case

On April 23, 1986, the Board of Directors of NL declared a dividend distribution of Preferred Rights pursuant to its Preferred Shares Rights Plan ("Plan") (A255) which was designed to provide protections to NL's stockholders of fair and equal treatment and against abusive tactics in takeovers (A240).

On June 18, 1986, NL received a letter from Harold C. Simmons, a notorious corporate raider and Amalgamated's controlling shareholder, stating that Simmons would like to negotiate a cash merger with NL at $15.00 per share in cash and stating that entities related to him (*e.g.*, Amalgamated) had bought over 10 million shares (approximately 17%) of NL's stock (A256).

On June 20, 1986, NL announced that it was filing a lawsuit against Simmons and Coniston Partners in New Jersey Superior Court alleging that Simmons, having induced a breach of the standstill agreement between NL and Coniston Partners, purchased more than 4% of NL's stock from Coniston Partners. Under the standstill agreement, Coniston was precluded from selling its NL stock to any person who would thereafter own more than 5% of NL's stock. The suit sought injunctive relief against Simmons exercising any control over the NL stock purchased from Coniston (A256). Simmons contended that the New Jersey state courts did not have jurisdiction over him.

On June 25, 1986, Amalgamated instituted litigation in New York federal district court against NL contesting the validity of NL's Preferred Rights (A256).

On June 30, 1986, Simmons announced that he and his affiliates (Amalgamated) had increased their ownership of NL's common stock to 20.4% from 17.5%, thereby intentionally triggering the distribution of NL's Preferred Rights to NL's common shareholders (A257).

By press release dated July 1, 1986, NL publicly announced that July 10, 1986, would be the distribution date for the separate trading of the Preferred Rights (A240-241). (Prior to Simmons acquiring over 20% of NL's common stock, the Preferred Rights were represented by NL's common stock share certificates and were not separately issued or traded (A240-241).)

On July 3, 1986, Amalgamated commenced a tender offer for all of NL's stock at $15.125 per share. Amalgamated's tender offer was conditioned upon a judicial determination that NL's Preferred Rights were illegal (A257).

In the federal litigation in the New York district court, NL had moved for a stay pending disposition of NL's New Jersey action against the Coniston Defendants and Simmons. On July 9, 1986, NL, in connection with NL's motion for a stay, agreed not to distribute certificates for public trading of the Preferred Rights (A270). Petitioner Rothenberg's class action in New Jersey Superior Court seeks, among other things, to compel the distribution of the Preferred Rights to the persons entitled to receive them, namely, all shareholders of NL as of the close of business on July 10, 1986) (A25, 27).

On August 5, 1986, the district court granted Amalgamated's motion for a preliminary injunction against NL's Preferred Shares Rights Plan stating that "I find that there is a probability of success on the merits so far as the plaintiff's [Amalgamated's] application to void the rights plan [as being illegal under New Jersey statutes] is concerned." *The Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F.Supp. 1229, 1239 (S.D.N.Y. 1986).

NL appealed forthwith to the Court of Appeals. On August 6, 1986, the Court of Appeals set oral argument for August 28th on NL's appeal of the preliminary injunction. The Court of Appeals also enjoined Amalgamated from purchasing any of NL's stock pursuant to its tender offer

(A273). Amalgamated then terminated its tender offer (Wall Street Journal, August 8, 1986, p. 8).

On August 6, 1986, plaintiff's complaint (which was forwarded to New Jersey counsel under cover of letter dated August 4, 1986) was filed in New Jersey Superior Court (A25).

On August 8, 1986, Amalgamated purchased on the open market an additional 14 million shares of NL's stock, increasing Amalgamated's total interest in NL to over 51% of NL's common stock (A275).

NL's management, seeing the handwriting on the wall, then capitulated, after first having obtained Simmon's agreement to substantial benefits for themselves and to the preservation of their jobs. Hence, on August 13, 1986, NL and Amalgamated entered into an agreement pursuant to which Amalgamated could designate, on *or before* August 18, 1986, a majority of NL's directors (A275, 301). Amalgamated also agreed with Mr. Rogers, NL's president, that it would recommend to NL's Board that it adopt a stock plan for present officers and key employees of NL (A275) and that Mr. Rogers could retire at age 55 with full benefits as if he had retired at the age of 60 (A275). It was further agreed that Mr. Rogers would continue on his job as Chairman of the Board, President, and Chief Executive Officer of NL through NL's 1988 meeting (A278). Amalgamated also agreed that management's "golden parachutes" were valid and binding obligations of NL, pursuant to which Mr. Rogers alone had already been paid over $2 million (A287-288).

The agreement between Amalgamated and NL further provided for the discontinuance of litigation between the parties (A279) and forms were annexed for the dismissal of NL's appeal to the Court of Appeals (A321) and for entry of a final judgment against NL in the district court declaring NL's Rights Plan invalid (A326).

On August 14, 1986, final judgment was entered in the district court, without objection by NL, declaring NL's Preferred Rights Plan null and void (A11).

Thereafter Amalgamated and NL moved for summary judgment in the *Rothenberg* action in New Jersey Superior Court. On January 9, 1987, the motions for summary judgment were heard before Judge Levy of the New Jersey Superior Court. Amalgamated and NL had moved for summary judgment upon the ground of *res judicata* and Simmons/NL also upon the ground of impossibility (namely, that NL was required to obey the federal judgment declaring its Preferred Rights Plan invalid under New Jersey law). Instead of proceeding in such piecemeal fashion, Simmons/Amalgamated/NL could also have moved for summary judgment upon the merits, namely, respecting the validity of NL's Preferred Rights Plan under New Jersey law, and Judge Levy expressed surprise that defendants had not done so (A96).

Judge Levy denied respondents' motions for summary judgment "without prejudice" (A107) upon the ground that the validity of the federal judgment involved a triable issue of fact respecting the existence of a justiciable case or controversy between Amalgamated and NL (A106-107) and invited counsel for respondents to move for summary judgment upon the merits (A106). Counsel for Amalgamated stated that he would do so (A108-109).

Instead, Amalgamated filed a motion for leave to appeal to the Appellate Division of the Superior Court of New Jersey and also for summary judgment (A111-113). By order dated February 13, 1987, the Appellate Division denied leave to appeal and also denied summary disposition in favor of Amalgamated (A146).

Instead of moving for summary judgment upon the merits, as counsel for Amalgamated had told Judge Levy he would do, Amalgamated then instituted proceedings in New York in federal district court. By order to show cause

dated March 4, 1987, Amalgamated moved pursuant to the "relitigation exception" of 28 U.S.C. §2283 ("to protect or effectuate its judgments") to enjoin Rothenberg from seeking relief premised on the asserted validity of NL's Preferred Shares Rights Plan (A12-14). The district court temporarily restrained petitioner Rothenberg from continuing to prosecute the *Rothenberg* action in New Jersey Superior Court (*Ibid.*).

Hearings were held in the district court on March 4, 1987 (A349), and March 13, 1987 (A397), and on March 18, 1987, the district court rendered its oral opinion in favor of Amalgamated (A553, *et seq.*). As noted, the district court signed an order dated March 23, 1987, permanently enjoining petitioner Rothenberg from seeking in the *Rothenberg* action in New Jersey Superior Court, or in other action, relief premised upon the asserted validity of NL's Plan (A583). Petitioner Rothenberg then appealed to the Court of Appeals from such order (A584).

C. Harold C. Simmons— The Notorious Corporate Raider

Through a bewildering array of corporations (A246-247), Harold C. Simmons owned, directly and indirectly, a majority of Amalgamated's common stock and was its Chairman of the Board and Chief Executive Officer (*Ibid.*). Amalgamated was Simmons' corporate instrumentality (*Ibid.*).

Simmons is a well-known corporate raider. In the litigation commenced in New Jersey Superior Court by NL on June 20, 1986 (*NL Industries, Inc. v. Simmons, et al.*, Docket No. 86-C-128), NL's complaint (A213) detailed Simmons' numerous corporate takeovers and his encounters with the courts and regulatory authorities (A221-229).

Subsequently, Simmons acquired, through one or more of his corporations, about 39% of the common stock of Sea-Land Corporation. In order to escape the rapacious clutches of Simmons, Sea-Land arranged in April 1986 to

be acquired by a "white knight" (*i.e.*, a friendly acquisitor), namely CSX Corporation, to which Simmons sold his 39% stake in Sea-land (Wall Street Journal, April 25, 1986, p. 12). Simmons' profit, as reported in the financial press, was more than $80 million.

Then, in June 1986 the incessant and implacable Simmons turned his attention to NL.

D. Simmons Intentionally Triggers the Distribution of the Preferred Rights In Order To Serve His Own Purposes

Commencing in June 1986, as noted, a fierce battle was waged between Simmons and NL in which Simmons sought to take over NL and in which Simmons was ultimately successful.

Prior thereto, on April 23, 1986, as also noted, NL's Board of Directors declared a dividend distribution of the Preferred Rights which are described at App. A, *infra*, pp. A9-13. Petitioner Rothenberg contends that the Preferred Rights are an entirely valid means, under New Jersey law, of providing protections to the stockholders of NL to fair and equal treatment and against abusive tactics in takeovers. This was also NL's position before NL was taken over by Simmons.

On June 30, 1986, as further noted, Simmons announced that he and his affiliates had increased their ownership of NL's common stock to 20.4% from 17.5%, thereby triggering the distribution of NL's Preferred Rights to NL's common shareholders (A257). In triggering the distribution of NL's Preferred Rights, Simmons thereby discouraged anyone else from acquiring all or part of NL at a better price than he was offering (A248).

After having thus triggered the distribution of NL's Preferred Rights to serve his own purposes, Simmons then sought in this litigation to enjoin the *Rothenberg* action

in New Jersey state courts to compel the distribution of the Rights to the shareholders of NL entitled to them.

E. The Instant Litigation Is Part of Simmons' Persistent and Continuing Efforts to Evade Having the New Jersey Courts Decide the Validity of NL's Preferred Shares Rights Plan Under New Jersey Law

The instant litigation by Simmons/Amalgamated is part of Simmons' persistent and continuing efforts to make an end-run around the courts of New Jersey upon one of the most important questions of New Jersey corporate law to arise in recent decades.

For reasons best known to himself, Simmons has strenuously endeavored to stay out of the New Jersey courts. First, as noted, he claimed that the New Jersey state courts did not have jurisdiction over him. Then, instead of suing in the New Jersey state courts for an authoritative and definitive ruling upon the validity of NL's Preferred Rights Plan under New Jersey law, Simmons instead chose to sue in federal court in New York and to have a federal judge try to surmise how the New Jersey state courts would decide a question of New Jersey corporate law which not only was of first impression in the New Jersey state courts but also was of overriding importance to many major corporations incorporated in New Jersey. Simmons also resisted NL's efforts to stay or dismiss the federal action in order to permit the New Jersey courts to decide the validity of NL's Preferred Rights under New Jersey law.

Now, in this litigation, Simmons/Amalgamated still seek—successfully thus far—to evade any decision upon the merits by the New Jersey state courts.

By hand-delivered letter dated August 1, 1986 (prior to any decision by the district court in New York), Rothenberg's counsel wrote a letter to the district court (A24).

That letter informed the district court and counsel for the parties that Rothenberg expected "to commence [an action] in the very near future in the New Jersey state courts for, *inter alia*, a declaratory judgment that the Preferred Rights of NL Industries, Inc., are valid under New Jersey law" and enclosed a draft of Rothenberg's New Jersey state complaint. The hope of Rothenberg's counsel was that the district court and the parties would opt to have the validity of NL's Preferred Rights Plan under New Jersey law decided by the New Jersey state courts. That hope was not realized. Instead, Simmons/Amalgamated continued to pursue the action in the New York district court in opposition to NL's motion therein for a stay or dismissal on the ground that New Jersey state law was controlling and that the New Jersey state courts should decide New Jersey state law.

Thus, if New York counsel for petitioner Rothenberg took any position in the New York federal action by his letter dated August 1, 1986, it was that the New Jersey state courts should decide the question of the validity of NL's Preferred Rights Plan under New Jersey law.

On August 5, 1984, the district court granted Amalgamated's motion for a preliminary injunction, stating that "the matter has presently been submitted to me on the single issue of whether the adoption of the rights plan by the directors of NL Industries was *ultra vires* under New Jersey law." (App. A, *infra*, p. A5); that "The parties agree that New Jersey law governs." (*Id.*, at A17); that "I find that there is a probability of success on the merits so far as the plaintiffs' application to void the rights plan is concerned." (*Id.*, at A35); and NL's motion for a stay or dismissal was denied because "I consider myself and I certainly consider my Court of Appeals as adequate to interpret New Jersey law." (*Id.*, at A37).

However, "my Court of Appeals" was never given the opportunity to decide the question because NL agreed

with Simmons after he acquired over 50% of NL's stock to enter the federal judgment declaring NL's Preferred Rights Plan invalid.

As stated, the question of the validity of the Preferred Shares Rights Plan is a legal issue of paramount importance. Many major corporations throughout the country, including New Jersey of course, have adopted these Rights Plans to protect their shareholders against abusive tactics in takeovers. As stated by one corporation in a letter to its shareholders announcing the adoption of a Rights Plan: "Approximately 200 other companies, including Time Inc., Mobil, Greyhound, Alcoa, General Mills, Ryder Systems, Santa Fe-Southern Pacific, United Technologies, McDonald's, Dart & Kraft, Household International and Colgate-Palmolive, have issued Rights of the kind we have approved." (A331).

The Supreme Court of Delaware has sustained the validity of Preferred Share Rights Plans. *Moran v. Household Int'l, Inc.*, 500 A2d 1346 (Del. 1985). The New Jersey state courts have not yet spoken on the question.

F. NL Agrees with Simmons to Enter the Judgment Declaring NL's Rights Plan Invalid

By press release dated August 5, 1986, NL stated (A272):

> "NL Industries, Inc. announced that it is seeking a stay from the United States Court of Appeals for the Second Circuit and an expedited appeal of the preliminary injunction against its Preferred Share Purchase Rights Plan entered today by the United States District Court for the Southern District of New York. NL stated that it has been advised that its legal counsel believes that the District Court's decision is contrary to precedent and misinterprets the applicable law. NL intends to continue vigorously to seek to uphold its Rights Plan and the protection it affords NL's

shareholders against the inadequate tender offer by the Simmons Group.

"NL stated that the Simmons Group agreed before the District Court not to purchase any securities tendered between the time of the District Court's opinion and 5:00 p.m. tomorrow.

"NL reiterated that its Board of Directors continues to believe that the Simmons Group's offer does not recognize the inherent value of NL and urged the NL shareholders not to tender any NL securities to the Simmons Group. NL stated that the Simmons Group is not committed to purchase any NL securities under its offer, and that NL shareholders who tender securities to the Simmons Group may not be able to get them back until after September 1, 1986, if they are not purchased."

By press release dated August 6, 1986, NL further announced (A273):

"NL Industries, Inc. announced that the U.S. Court of Appeals for the Second Circuit has entered an injunction against the Simmons Group's purchasing any securities of NL Industries pursuant to its tender offer until the close of business on August 28, 1986. The Second Circuit has set oral argument for August 28th on NL's appeal of the preliminary injunction entered yesterday against NL's Preferred Share Purchase Rights Plan * * * "

However, on August 14, 1986, final judgment was entered in federal New York district court against NL, without opposition by NL, declaring invalid NL's Preferred Rights Plan (A11).

As discussed, what had happened in the interim was that Simmons acquired over 51% of NL's common stock and that NL's management, seeing the handwriting on the wall, capitulated, after first having obtained Simmons' agree-

ment to substantial benefits for themselves and to the preservation of their jobs.

REASONS FOR GRANTING THE WRIT

I. The within federal injunction against the prosecution in the New Jersey state courts of the instant class action to determine the validity under New Jersey law of the New Jersey corporation's Preferred Shares Rights Plan and to enforce the right of the class to receive the duly declared Rights dividend is contrary to established principles of abstention and, moreover, federalizes state corporation law.

The "relitigation" about which Simmons/Amalgamated complains results directly from Simmons' persistent efforts to evade having the New Jersey state courts decide the validity of NL's Preferred Shares Rights Plan under New Jersey law. Except for Simmons' persistent and continuing efforts to make an end-run around the courts of New Jersey upon one of the most important questions of New Jersey corporate law to arise in recent decades, the validity of NL's Plan would have been decided—definitively and authoritatively—long ago in one litigation in the New Jersey state courts.

In the original litigation between Amalgamated and NL in the court below, it was plain error for the district court not to have stayed the action before it, as requested by NL, in order to permit the New Jersey state courts to decide the validity of NL's Plan under New Jersey law. Moreover, Simmons/Amalgamated were able to preclude appellate review by the Court of Appeals by purchasing over 51% of NL's stock and obtaining the immediate right to name a majority of NL's directors and thereby acquiring control over NL. The district court's present injunction against

the *Rothenberg* action in the New Jersey state courts simply compounds its original error.

Under the *Younger* ground for abstention (*Younger v. Harris*, 401 U.S. 37 (1971)), the federal courts will abstain from interferring with a pending state civil proceeding even though constitutional issues are raised in the federal action where, as here, "the State's interest in the proceeding are so important that exercise of the federal judicial power would disregard the comity between the States and the National Government." *Pennzoil Co. v. Texaco, Inc.*, 107 S.Ct. 1519, 1526 (1987).

Also, under the *Burford* ground for abstention (*Burford v. Sun Oil Co.*, 319 U.S. 315 (1943)), the federal courts will abstain where, as here, there are important and unsettled issues of state law bearing on state policy. Abstention is "appropriate where there have been presented difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case at bar." *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 814 (1976).

Both grounds for abstention (*Younger* and *Burford*) are applicable here. As stated in *Pennzoil* (107 S. Ct., p. 1526, n. 9): "The various types of abstention are not rigid pigeonholes into which federal courts must try to fit cases. Rather, they reflect a complex of considerations designed to soften the tensions inherent in a system that contemplates parallel judicial processes."

There are no "automatic exceptions" to Section 2283. This Court has stated that, despite the existence of an express exception to Section 2283, it did not "question or qualify in any way the principles of equity, comity, and federalism that must restrain a federal court when asked to enjoin a state proceeding . . . " *Mitchum v. Foster*, 407 U.S. 238, 243 (1972).

"Even if an injunction against state proceedings is not barred by §2283, it may still be refused. The various

abstention doctrines may counsel that the federal court refrain from exercising its power to issue an injunction." Wright, *Law of Federal Courts*, p. 286 (Hornbook 4th ed. 1983).

Still further: "Because of the sensitive nature of interfering with state court systems, district courts require that parties requesting an injunction make a strong and unequivocal showing of relitigation." *First Alabama Bank v. Parsons Steel, Inc.*, 747 F.2d 1367 (11th Cir. 1983), *rev'd on other grounds*, 106 S. Ct. 768 (1986). Here, at a minimum, serious doubts exist as to whether the prior federal judgment is *res judicata* against Rothenberg in the New Jersey action (Points III, IV and V, *infra*). Indeed, the New Jersey Superior Court in the *Rothenberg* action denied the motion of Amalgamated (and NL) for summary judgment upon the ground of *res judicata* and the New Jersey Appellate Division denied leave to appeal.

Moreover, the federal injunction in this case against the *Rothenberg* action in the New Jersey state courts goes a long way toward federalizing state corporation law. Most persons challenging defensive corporate measures in respect of corporate takeovers will seek, as Simmons did in this case, to litigate in the federal courts so as to avoid what they perceive to be a forum friendly to the threatened corporation, namely, the state courts of the state of incorporation. The end result is to concentrate such litigation in the federal courts, which are called upon to decide important and unsettled questions of state corporation law to the exclusion of the state courts.

In this very case, for example, the district court found that "the purchase rights plan was *ultra vires* as a matter of New Jersey state law because it allowed discrimination among shareholders of the same class and series . . . and because the plan effectively prevented stockholders from receiving tender offers" (App. C, *infra*, p. C5). However, this Court, in sustaining the validity of an Indiana statute regulating corporate takeovers, stated: "No principle of

corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1649 (1987).

The injunction in this case arrogates to the federal courts the power to regulate domestic corporations while precluding the State, through its courts, from doing so.

Under general principles of equity, comity and federalism—all subsumed under the heading of abstention—the district court should have declined to grant the highly intrusive remedy of a federal court injunction against state court proceedings to determine an important and unsettled question of state law. It is highly intrusive and anomalous, to say the least, for a federal court to enjoin a state court proceeding, even upon the ground of the claimed *res judicata* effect of a prior consent federal judgment, to determine a state law question bearing on important policy problems which the state courts—and only the state courts—are competent to decide definitively.

The Court of Appeals faults Rothenberg for not intervening in the federal action (App. C, *infra*, p. C17). Such intervention would have required Rothenberg to surrender his basic position that the validity of NL's Plan under New Jersey law should be decided by New Jersey courts. Moreover, NL acted without notice to its shareholders in withdrawing its appeal and in not objecting to entry of the final judgment.

II. In its opinion herein, the Court of Appeals, contrary to the sound administration of justice, affirmatively and expressly encourages a state court defendant to take "two bites at the apple," that is, to litigate the question of *res judicata* two times successively in two different courts—first in state court and then, if unsuccessful there, in federal court under Section 2283.

Respondent Amalgamated is a defendant in the New Jersey state class action commenced by petitioner Richard Rothenberg, plaintiff therein, in August 1986 to enforce the right of Rothenberg and the class to receive the dividend which had been duly declared by NL pursuant to NL's Preferred Shares Rights Plan. Amalgamated's answer, dated October 1986, pleaded in its Second Affirmative Defense the final consent judgment of the district court as being *res judicata* (A336, 341).

By motion returnable in December 1986 (A44), Amalgamated moved in New Jersey Superior Court for summary judgment upon the ground of *res judicata*, which motion was denied by order dated January 9, 1987 (A345-346), without prejudice upon the ground that triable issues of fact existed respecting the validity of the federal judgment (A106-107). Counsel for Amalgamated then stated that he would move for summary judgment upon the merits, namely, the alleged invalidity of NL Industries' ("NL") Preferred Shares Rights Plan (A108-109).

Instead, Amalgamated moved in the Appellate Division of New Jersey for (1) leave to appeal and (2) summary judgment in favor of Amalgamated upon the ground of *res judicata* (A111-113). The Appellate Division by order dated February 13, 1987 (A146), denied both leave to appeal and Amalgamated's motion for summary judgment.

Amalgamated then filed papers in the district court on or about March 4, 1987, to enjoin Rothenberg's prosecution of the New Jersey class action (A12-14). Amalgamated did not seek any relief in federal court until after it lost its motions for summary judgment in the state action, upon which motions considerable time and effort were expended by all parties.

In coming to federal court for relief only after having lost upon its claim of *res judicata* in the New Jersey state courts, Amalgamated seeks "two bites at the apple." *First Alabama Bank v. Parsons Steel, Inc., supra,* 747 F.2d at 1381 (dissenting opinion). Amalgamated has waived its right to an injunction in federal court under Section 2283 against prosecution of the *Rothenberg* action in the New Jersey state courts.

In *Parsons Steel,* as here, a state court defendant lost in state trial court upon its claim that prior federal judgment in its favor was *res judicata* and there, as here, state court defendants thereafter sued in federal court for injunction against further prosecution of state court case against it under "relitigation exception" of Anti-Injunction Act. This Court held that, "Even if the state court mistakenly rejected respondent's [state defendants'] claim of res judicata, this does not justify the highly instrusive remedy of a federal-court injunction against the enforcement of the state-court judgment", and that, "challenges to the correctness of a state court's determination as to the conclusive effect of a federal judgment must be pursued by way of appeal through the state-court system and certiorari from this Court . . . " (106 S. Ct. at p. 773). This Court therefore reversed, holding that it was error for the Eleventh Circuit to have refused to consider the preclusive effect of the state court's decision upon the issue of *res judicata.*

The majority of the Court of Appeals held in *Parsons Steel* that there had been no waiver of rights under Section 2283, stating (747 F.2d, at p. 1376):

> "Appellants' next two arguments relate to the point in time at which the Bank requested a federal injunction. First, appellants argue that the Bank waived its right to an injunction by waiting until after the state action had been tried before requesting an injunction under the relitigation exception. The Bank argues that if it had requested an injunction before the state trial, the federal court would have been inclined to deny the injunction since the state court pleadings obfuscated the fact that the state action involved the same basic cause of action which was tried in the BHCA action. The district court agreed that the pleadings were the source of confusion in these two actions and held that the Bank had not waived its right to an injunction by delaying until after the state trial. We see no reason to disturb this holding. The Bank should not be penalized for its reluctance to come back to federal court while it was not clear whether the federal court's prior judgment was in danger of being nullified."

No such claim of confusion in the pleadings can be made by Amalgamated in this litigation. The dissenting opinion, as noted, stated in *Parsons Steel* that the majority was allowing the defendant bank "two bites at the apple." (*Id.*, at p. 1381), which certainly is the case here.

In its opinion herein, the Court of Appeals stated: "Amalgamated acted properly in moving for summary judgment on *res judicata* grounds in the New Jersey court prior to seeking injunctive relief in the district court, thereby attempting to avoid invoking the more intrusive remedy of injunctive relief." (App. C., *infra.*, p. C17). The opinion below thus affirmatively and expressly encourages a state court defendant to take "two bites at the apple."

There is nothing whatever to be said in favor of permitting a state court defendant to litigate the question of *res judicata*

two times successively in two different courts—first in state court and then, if unsuccessful there, in federal court under Section 2283. Amalgamated should be held to have waived its rights under Section 2283 by first litigating—and losing—upon its claim of *res judicata* in the New Jersey state courts, particularly since counsel for Amalgamated assured Judge Levy of the New Jersey Superior Court, after he denied summary judgment upon the grounds of *res judicata*, that Amalgamated would move for summary judgment upon the merits (A108-109).

The opinion below is contrary to the sound administration of justice.

III. The federal injunction herein is contrary to the established federal rule of *res judicata* that a judgment against a corporation is not *res judicata* against the corporation's shareholders, particularly where, as here, many, if not most, of the class had sold their stock in the corporation before entry of the consent judgment.

Federal law governs the *res judicata* effect of a federal judgment even where rendered in a diversity case. *Kern v. Hettinger*, 303 F.2d 333, 340 (2d Cir. 1962) ("One of the strongest policies a court can have is that of determining the scope of its own judgments."); *PRC Harris, Inc., v. Boeing Co.*, 700 F.2d 894, 896 n. 1 (2d Cir. 1983) (" . . . while state law [in diversity case] controlled the rights and obligations of the parties, determining the *res judicata* effect that will be given the judgment of a federal court is distinctively a matter of federal law."); *Hunt v. Liberty Lobby, Inc.*, 707 F.2d 1493, 1497 (D.C. Cir. 1983) ("We hold therefore that the federal court in exercising its diversity jurisdiction here shall apply federal rules of *res judicata* in determining the effect to be given the judgment rendered by the federal court in Florida exercising diversity jurisdiction.").

Federal authorities clearly hold that judgment against a corporation is not preclusive as against the corporation's stockholders. *E.g., Zenith Radio Corp. v. Hazeltine Research Co.*, 395 U.S. 100, 110 (1969); *In re Teltronics Services, Inc.*, 762 F.2d 185, 191 (2d Cir. 1985) (claims asserted by president of corporation barred by *res judicata* because he participated in and controlled prior litigation in which judgment was entered against corporation, "[a]lthough ordinarily a stockholder is not bound by determinations made against his corporation . . . "); *Ritchie v. Landau*, 475 F.2d 151, 155, n. 2 (2d Cir. 1973) (same); *Dudley v. Smith*, 504 F.2d 979, 982 (5th Cir. 1974) ("Stockholders and officers are not in privity to and are not personally barred by judgments against their corporations."); 1B Moore's, *Federal Practice*, ¶0.411 [11] p. 478 ("the sound general rule is that [for purposes of *res judicata*] the stockholder corporation relationship does not of itself establish privity."); 18 Wright, Miller & Cooper, *Federal Practice & Procedure*, §4460, p. 533 ("Corporations are treated as entities separate from their officers, directors, and shareholders for purposes of preclusion just as for other purposes. Without more, judgments entered in actions against any one of them are not binding on any other.").

The decision by this Court in *Zenith Radio Corp. v. Hazeltine Research Co., supra*, is conclusive. There, the wholly owned subsidiary of Hazeltine sued defendant for patent infringement and defendant counterclaimed for antitrust treble damages. Hazeltine did not appear in the action and was not served. The subsidiary and defendant had stipulated that the subsidiary and Hazeltine were to be considered as one entity for purposes of the litigation. The district court found that Hazeltine and its subsidiary conspired with one another to exclude defendants from certain markets. This Court held that Hazeltine was not subject to or bound by the judgment granting injunctive and monetary relief against its subsidiary, stating (*Id.*, at p. 110, 111):

> "The Court of Appeals was quite right in vacating the judgments against Hazeltine. It is

elementary that one is not bound by a judgment *in personam* resulting from litigation in which he is not designated as a party or to which he has not been made a party by service of process. *Hansberry v. Lee,* 311 U.S. 32, 40-41, 61 S.Ct. 115, 117, 85 L.Ed. 22 (1940). The consistent constitutional rule has been that a court has no power to adjudicate a personal claim or obligation unless it has jurisdiction over the person of the defendant. *E.g., Pennoyer v. Neff,* 95 U.S. 714, 24 L.Ed. 565 (1878); *Vanderbilt v. Vanderbilt,* 354 U.S. 416, 418, 77 S.Ct. 1360, 1362, L.Ed. 2d 1456 (1957).

"Here, Hazeltine was not named as a party, was never served and did not formally appear at the trial. Nor was the stipulation an adequate substitute for the normal methods of obtaining jurisdiction over a person or a corporation. . . . " (p. 110)

* * *

"Likewise, were it shown that Hazeltine through its officer, Dodds, in fact controlled the litigation on behalf of HRI [the subsidiary], and if the claim were made that the judgment against HRI would be *res judicata* against Hazeltine because of this control, that claim itself could be finally adjudicated against Hazeltine only in a court with jurisdiction over that company. (cases cited)" (p. 111)

This Court thus clearly indicated in *Zenith Radio* that a judgment against a corporation is not *res judicata* against even a 100% shareholder in the absence of special circumstances, such as control by the 100% shareholder over the first litigation.

Moreover, many, if not most, of the class had sold their NL stock prior to entry of the federal court consent judgment. The class represented in the *Rothenberg* action in the New

Jersey state courts is all shareholders of NL as of record on July 10, 1986 (A25, 27). The consent federal judgment was not entered until August 14, 1986 (A11). By that time, many, if not most, of the class had sold their NL stock. Note, for example, that on August 8, 1986, Amalgamated purchased on the open market 14 million shares of NL's stock, increasing Amalgamated's total interest in NL from 17% (A256) to over 51% of NL's common stock (A275).

IV. The prior consent judgment against the corporation is not *res judicata* against the class for the further reason that under established law the corporation's withdrawal of its appeal and consent to entry of judgment against it rendered the corporation an inadequate representative of the class.

NL publicly stated that "its legal counsel believes that the district court's decision is contrary to precedent and misinterprets applicable law" and that "NL intends to continue vigorously to seek to uphold [by appeal] its Rights Plan and the protection it affords NL shareholders [against Simmons]" (A272). A few days later, when Simmons acquired over 51% of NL's stock and agreed to substantial benefits for NL's management and the preservation of their jobs, NL discontinued its appeal to the Court of Appeals and did not oppose entry of judgment against it in district court declaring invalid its Rights Plan.

The consensual nature of the federal judgment means that NL was not an adequate representative of the class of NL shareholders represented in petitioner Rothenberg's New Jersey class action. *Gonzales v. Cassidy*, 474 F.2d 67, 74 (5th Cir. 1973) (failure to appeal rendered class representative inadequate; "Due process of law would be violated for the judgment in a class suit to be *res judicata* to the absent members of a class unless the court applying *res judicata* can conclude that the class was adequately represented in first

suit."); *Delta Airlines Inc. v. McCoy Restaurants Inc.*, 708 F.2d 582, 587 (11th Cir. 1983) (state plaintiff would not be enjoined under relitigation exception of Section 2283 where state agency's newly appointed board dismissed claim in question with prejudice in prior federal action because state plaintiff was not adequately represented by newly appointed board).

Once Simmons acquired over 50% of NL's stock, the interests of NL and of the class diverged. NL's primary interest then became reaching an accommodation with Simmons, not its Preferred Shares Rights Plan.

V. The prior consent judgment is not *res judicata* against the class for the still further reason that under established law the controversy between Amalgamated and the corporation had become moot when Amalgamated obtained 51% of the corporation's stock and the immediate right to name a majority of the corporation's directors and thus acquired control over the corporation.

The federal judgment was void because it was entered after Simmons/Amalgamated had acquired over 51% of NL's stock and was in control of NL by virtue of having obtained the immediate right to name a majority of NL's directors (A275, 292). Thus, at the time of the entry of the federal judgment, there was no longer a justiciable case or controversy between Simmons/Amalgamated and NL because NL had come under the control of Simmons/Amalgamated. Instead, the case or controversy between Simmons/Amalgamated and Simmons/NL had become moot because there was no longer an arms-length and adversarial relationship between the two entities.

It is a constitutional requirement for the exercise of federal jurisdiction that there be a justiciable "case or controversy" (U.S. Constitution, Art. III). "The basic inquiry is whether

the 'conflicting contentions of the parties . . . present a real, substantial controversy between parties having adverse legal interests . . . '" *Babbitt v. United Farm Workers Nat. Union*, 442 U.S. 289, 298 (1979). Also, the parties "may not by stipulation invoke the judicial power of the United States in litigation which does not present an actual 'case or controversy' . . . " *Memphis Light, Gas & Water Division v. Craft*, 436 U.S. 1, 7 (1978).

Upon becoming moot, the action in federal court between Simmons/Amalgamated and Simmons/NL was required to be dismissed. *Golden v. Zwickler*, 394 U.S. 103, 110 (1969) (where case became moot, "case is remanded with direction to enter a new judgment dismissing the complaint."); 6A Moore's, *supra*, ¶57.13, p. 57-117.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Dated: New York, New York
October 23, 1987

Respectfully submitted,

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Attorney for Petitioner

Appendix A—Opinion of the District Court in *The Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F. Supp. 1229 (S.D.N.Y)

The AMALGAMATED SUGAR COMPANY, LLC Corporation and LN Partnership,

v.

NL INDUSTRIES, INC., Robert A. Bicks, Nicholas F. Brady, Maurice F. Granville, William A. Marquard, James F. Mathis, Theodore C. Rogers, Jan M. Ross, Herman C. Schmidt, Robert G. Schwartz, Donald V. Seibert, Eleanor B. Sheldon and Thomas P. Stafford, Defendants.

No. 86 Civ. 5010 (VLB).

United States District Court,
S.D. New York.

Aug. 5, 1986.

Shareholder who wished to make tender offer brought action challenging voting rights plan adopted by board of directors. The District Court, Vincent L. Broderick, J., held that: (1) rights plan adopted by board of directors which utilized flip-in plan diluted voting rights and equity of acquiring shareholder and was

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ultra vires under New Jersey law proscribing discrimination among shareholders of same class and series, and (2) shareholder who wished to make tender offer was entitled to preliminary injunction against implementation of the plan.

Ordered accordingly.

1. Corporations ⇐310(1)

Shareholder rights plan, adopted by board of directors of corporation which was takeover target, utilized flip-in plan which diluted voting rights and equity of acquiring shareholders, and was ultra vires under New Jersey law proscribing discrimination among shareholders of same class and series. N.J.S.A. 14A:1–1 et seq., 14A:7–1, 14A:7–1(1), (2)(f), 14A:7–2.

2. Injunction ⇐138.42

Shareholder who wished to make tender offer for stock of corporation whose board of directors had adopted shareholder rights plan which utilized flip-in provision which would dilute voting rights and equity of acquiring shareholder was entitled to preliminary injunction against implementa-

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tion of the plan; the plan was ultra vires under New Jersey law proscribing discrimination among shareholders of same class and series, and acquiring shareholder would be irreparably harmed, since defendants conceded that if the plan were found valid, no one would make tender offer for ten years, and board of directors abdicated future responsibility with regard to tender offers. N.J.S.A. 14A:1–1 et seq., 14A:7–1, 14A:7–1(1), (2)(f), 14A:7–2.

Townley & Updike, Kirkland & Ellis, for plaintiffs; James K. Leader, Thomas A. Gottschalk, Philip S. Beck, of counsel.

Wachtell Lipton Rosen & Katz, for defendants; Paul Vizcarrondo, Jr., Robert B. Mazur, Paul Rowe, of counsel.

Oral Decision

VINCENT L. BRODERICK, District Judge.

I shall be dealing with the plaintiffs' motion for a preliminary injunction and the defendants' motion to stay or dismiss. What I have to say will constitute my findings of fact and conclusions of law for the purposes of the motion for a preliminary injunction.

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I find on what is before me that I do have jurisdiction over this action under 28 U.S.C. § 1332 (a)(1), since more than $10,000 is involved and the plaintiffs and defendants are from different states. I also find that I have jurisdiction under 15 U.S.C. section 78aa and 28 U.S.C. § 1331. I have pendent jurisdiction with respect to the state claims and the preliminary injunction pertains to a state claim.

With respect to the defendants' motion for a stay or dismissal on the grounds that the matter involved in this is to such a large extent concerned with New Jersey State law, I shall deal with that later. I will note at this point that the defendants did agree that no distribution of rights certificates would be made until that stay motion was decided.

I will take up now plaintiffs' motion for a preliminary injunction. This motion as originally made was predicated upon two grounds. First that the directors of the defendant corporation did not have the power under New Jersey law to adopt the rights plan which was adopted on April 23; and the second challenge has to do with the duty of the directors in passing upon that whether they breached their duties of using business judgment, acting as fiduciar-

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ies, and of loyalty. It has been agreed by the parties that the matter has presently been submitted to me on the single issue of whether the adoption of the rights plan by the directors of NL Industries was *ultra vires* under New Jersey law.

The Amalgamated Sugar Company is a corporation organized and existing under the laws of Utah with principal place of business in Utah. LLC Corporation, another plaintiff, is a corporation which is organized and existing under the laws of the state of Delaware with principal place of business in Texas. LN Partnership is a general partnership organized and existing under the laws of the state of Texas with principal place of business in Texas. NL Acquisition Corp. is a wholly owned subsidiary of Amalgamated which was formed for the purpose of making a tender offer for any or all shares of NLI common stock. NLI is a corporation organized and existing under the laws of the state of New Jersey with principal place of business in New York. It is primarily engaged in petroleum services and chemicals production.

The individual defendants are directors of NLI including Mr. Theodore Rogers, who is chairman, president and chief executive officer. The individual defendants are

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all citizens of states other than Delaware, Texas and Utah. There is one director, Mr. St. Clair, who is not a defendant, apparently because his presence would have destroyed diversity.

NLI in recent years has performed poorly, in terms of its own operations and in terms of the price of its stock in the market. The company has announced write-offs of nearly $250,000,000 in assets for the second quarter of 1986. Its price on the market has declined in recent years. In 1985 it traded from $9, $10, to $14.50.

On March 25 of this year Coniston Partners, with its affiliates, which then held approximately eight percent of NLI's stock, proposed to acquire NLI at a price of $16 per share in cash and securities. At the time NLI's common stock was trading at $14 per share. The board of directors of NLI apparently rejected Coniston's offer without presenting it to the NLI stockholders. NLI then on or about April 12, 1986 concluded a buy-back agreement with Coniston purchasing, I believe it was, half of the NLI shares held by Coniston and its affiliates for $14.75 per share.

The directors of NLI, apparently concerned by the possibility of another take-over threat such as that posed by Coniston, developed and adopted a restructuring plan which was announced on April 14. This plan included a reversion to NLI of excess pension funds in the amount of some $120,000,000, an initial public offering of a percentage, I believe it was 20 percent, of the stock of its subsidiary NL Chemicals, and a repurchase of NLI shares.

This repurchase was to be effected by the buy-back agreement with Coniston, which I have already discussed, and by making a self tender offer for 7-½ to 10 million NLI shares in a price range set by NLI's board of directors between $15-⅛ and $16.

NLI basically consists of two businesses: the oil service business and the chemical business. The oil service business has been in a general recession which is related to the world-wide oil glut. The chemical business has been profitable. The directors of NLI believed that its shares were under-valued in the market. The reason for this under-valuation was that it was basically regarded as an oil service company and monitored by analysts skilled in

that field who did not appropriately value the chemical business. The directors were concerned that, because of this under-valuation which they perceived, the company would be vulnerable to a takeover—perhaps a takeover of a two-tier variety where control was secured through a tender for part of the shares and the takeover would be financed by part of the assets of the company, with the remaining minority shareholders being bought out for less than adequate consideration.

They feared, in short, that the value they perceived in the company, that was not presently reflected in share market price, would be realized by the acquirer and not the company's shareholders.

In March of 1986, while the Coniston interest was still alive, the NLI board considered but did not adopt a rights plan. At the NLI board meeting which was held on April 23 of this year a rights plan was presented and adopted. The directors received a memorandum from counsel outlining the plan along with drafts of the plan, of a letter to shareholders, and of a press release announcing its adoption.

Counsel's memorandum observed that the purpose of the plan was to deter takeover attempts on terms not approved by the directors. The board adopted the proposed plan on April 23 without submitting it for shareholder approval. The annual shareholders' meeting was also held that day.

Under the plan adopted by the NLI board, NLI declared a dividend of one right per share to all common shareholders of record as of May 30, 1986. These rights initially could be traded only with the shares and could not be exercised. Unless redeemed, the rights, according to the plan, extended for ten years until May 30, 1996. The rights were redeemable for five cents each until the first trigger occurred: an announcement that a shareholder held 20 percent or more of NLI common or that a tender offer was to be commenced for 30 percent or more of NLI stock.

Either of these occurrences constitutes the first triggering incident, and after either occurrence, the rights certificates were to be distributed to all shareholders. They were at that point to be nonredeemable and to be transferable on the New York Stock Exchange.

The certificates issued to a shareholder who held 20 percent or more were to bear a legend which spelled out that the rights represented by the certificates could become null and void. Once distributed, as I already noted, the rights could be traded separately from the common stock.

Under the plan each right nominally entitles the holder to purchase 1/100th share of a newly issued junior preferred stock of NLI. To purchase a 1/100th share of such stock, the right-holder would have to pay a $50 exercise price. This exercise price was set in this disproportionately high amount, disproportionate relative to the present value of the right, in order that it would be "out of the money."

When any of several types of transactions which constitute a second trigger, such as a merger, occur the plan's flip-in provisions, under Section 11, or flip-over provisions, under section 13, will be activated.

Section 11 of the plan is the flip-in. It comes into play if NLI is the surviving entity in a merger with the 20 percent shareholder. If any one of numerous business transactions occurs or if an acquiring

person's stake or the 20 percent shareholder's stake in NLI is increased by 1 percent by reason of a reverse stock split or some other corporate transaction, under the flip-in provision, after trigger, and this is the second trigger, all right's holders, except the acquiring person, are entitled to purchase $100 worth of NLI common stock for $50, and the acquiring person's rights become void.

This process self-evidently effects a substantial dilution of the acquiring person's equity in NLI and of his voting power. It will have a similar effect on the equity and voting power of other common stock shareholders who have transferred their rights.

Under section 13 of the plan, which is the flip-over provision, if an acquiring person merges or otherwise combines with NLI and the acquiring person is the surviving entity, each right would flip-over into a right to buy $100 worth of the acquiring company's stock at a price of only $50.

Once the first trigger occurs, and rights have been triggered, the dilution with respect to a flip-in would occur with respect to subsequent acquiring persons, even white knights. NLI apparently acknowledges that upon the issuance of the rights,

the rights plan precludes NLI from being able to negotiate with third persons or complete a transaction for the entire company with a white knight.

The plan is not triggered if the entity purchasing 20 percent of NLI stock is NLI itself or one of its subsidiaries or its employee benefits plan.

Because the thrust of this plan, once the original trigger takes place, and it has taken place, is so important to my resolution of the issue before me, I am going to discuss the operation of the flip-in provision and of the way in which, if the second trigger is pulled, it subjects an acquiring person's interests, voting rights and equity, to discriminatory dilution.

If the flip-in is triggered when NLI's common stock is trading at $12.50 per share, each NLI right-holder, except for the acquiring shareholder, will be entitled to buy eight additional common shares with a value of $100 for the exercise price of $50 and thereby obtain eight additional common shares and eight additional votes. However, the acquiring person, the 20 percent shareholder whose rights have been voided, will not be able to obtain any additional shares in the same manner. Thus the triggering of the flip-in provision would

allow all common shareholders who hold rights, except the acquiring shareholder, the 20 percent shareholder, to have nine votes for each common share previously owned. The 20 percent shareholder would have the same number of shares and the same number of votes as he had before. His voting rights therefore would have been substantially diluted.

This flip-in provision similarly subjects an acquiring person's equity to discriminatory dilution. Assume that the flip-in is triggered when there are 60,000,000 common shares outstanding, the market price is $12.50 per share and all rights-holders, other than the acquiring person, exercise their rights by buying eight shares for each right at $6–¼ per share. Under these circumstances, if the acquirer had paid $450,000,000 for 60 percent of the outstanding common shares of NLI, the triggering of the flip-in provision would reduce the acquirer's equity to $279,000,000.

A letter to shareholders signed by Mr. Theodore Rogers, the president and chairman, stated that a principal purpose of the NLI rights plan was to deter "any attempt to acquire the company in a manner or on terms not approved by the board."

On June 11 of this year, NLI's stock price on the market fell below $12. On June 18 Harold Simmons, who was the chairman of Amalgamated, wrote to NLI proposing to buy all NLI shares for $15 or all shares that had been tendered to NLI at $15–¼.

On June 24, 1986 Mr. Simmons asked the NLI board of directors to redeem the rights which had been issued under the rights plan in order to preserve the company's flexibility in view of the plaintiffs' interest in purchasing more shares and crossing the 20 percent threshold established under the rights plan. NLI's board met on June 25. It cancelled its self-tender offer; it authorized the sale of 18 percent of NL Chemicals' stock; it rejected Mr. Simmons' proposals and his request that the rights be redeemed; and it explained to shareholders that "underlying these board actions is its belief that the inherent value of the company's component businesses is significantly greater than the price proposed by Mr. Simmons."

On June 25 this suit to enjoin the operation of NLI's rights plan was filed.

On June 30 the plaintiffs announced that their holdings of NLI common exceeded 20 percent. This constituted the first trigger under the rights plan. (Pursuant to the agreement, previously mentioned, defendants have agreed not to distribute the rights certificates. Thus public trading in the rights separate from the common has not occurred.) The next day, plaintiffs announced that they would commence a cash tender offer for any and all NLI shares including rights and later dividends for $15–⅛ per share. That tender offer was formally commenced on July 3rd.

Plaintiffs conditioned their tender offer on judicial invalidation of the Pill. Another principal condition was financing. The plaintiffs have represented that financing commitments are conditioned on the Pill's invalidation.

The NLI board of directors characterized plaintiffs' offer on July 11 as financially inadequate. On July 14 the NLI board decided to cancel its sale of NL Chemicals' stock and to spin off 100 percent of NL

Chemicals as a dividend to common shareholders. Its stated purpose for this spin-off was to enhance shareholder values in the face of plaintiffs' offer.

The board authorized distribution of depositary receipts representing shares of NLI's newly created Series C preferred stock in order to provide a functional equivalent to NL Chemicals' common and to allow public trading therein prior to the time the common stock of NL Chemicals would be issued.

In response to NLI's spin-off the plaintiffs supplemented their offer on July 25, stating that they would accept tenders of NLI common coupled with rights but not depositary receipts for $3.50 per share, and that they would accept tenders of such units plus depositary receipts at $15–⅛. They also reserved the right to return the depositary receipts.

The tender offer was due to expire by operation of law at midnight on July 31. At that time all tenders were to be in and the plaintiffs would have been free to purchase tendered shares.

Pending decision on this motion for preliminary injunction it is my understanding that the plaintiffs have extended their offer on a day-to-day basis.

At the heart of this controversy is the validity of the flip-in and flip-over provisions of the NLI plan.

The parties agree that New Jersey law governs. Plaintiffs have principally relied on two federal district court cases construing New Jersey law. See *Minstar Acquiring Corp. v. AMF Inc.*, 621 F.Supp. 1252 (SDNY 1985), *Asarco Inc. v. Court*, 611 F.Supp. 468 (DCNJ 1985).

Defendants have argued that these cases do not govern this rights plan, and that instead this court should rely on a Second Circuit decision analyzing New Jersey law and that it should look to Delaware law as well. See *Treadway Cos. Inc. v. Care Corp.*, 638 F.2d 357 (1980), *Moran v. Household Intern.*, 500 A.2d 1346 (Del. 1985), *Revlon v. MacAndrews & Forbes*, 506 A.2d 173 (Del.1986), *Dynamics v. CTS*, Fed.Sec.L.Rep. (CCH), para 92, 736 (N.D. Ill. April 17, 1986.)

A preliminary injunction may only be issued if the party seeking that injunction establishes either a likelihood of success on the merits or a seriously litigated issue with a balance of hardship tipping in the plaintiffs' favor.

On either showing the party seeking a preliminary injunction must also establish probable irreparable harm.

With respect to the merits, the plaintiffs urge this court to find that the rights plan adopted by NLI is not valid under New Jersey law for three reasons: That New Jersey law forbids discrimination among shareholders of the same class and series, that New Jersey law forbids unreasonable restraints on share alienation, and that New Jersey law forbids any device by which the board is given veto power over hostile offers unless there has been shareholder approval.

[1] I find that the rights plan, and in particular the flip-in provision of that plan, since principal focus has been on that provision in the course of the presentation of this case, is *ultra vires* as a matter of New Jersey Business Corporation law. The flip-in effects a discrimination among shareholders of the same class or series. Under the plan the voting rights and the equity of an acquiring shareholder are diluted upon a triggering event. I have already discussed the arithmetic of that dilution. It is a dilution that affects voting power and it is a dilution that affects equity.

New Jersey law clearly does not allow discrimination among shareholders of the same class and series. New Jersey Business Corporation Act, sections 14A: 7–1 and 7–2 permit differences in voting rights between classes or series of stocks. Section 7–1(1) empowers New Jersey corporations to create and issue shares of stock. It states that "each class and series may have such designation and such relative voting, dividend, liquidation and other rights preferences, and limitations as shall be stated in the certificate of incorporation."

Section 7–1(2)(f) provides that "when so authorized in its certificate of incorporation" a corporation "may issue classes of shares in series of shares of any class," and then (f) "lacking voting rights or having limited voting rights or enjoying special or multiple voting rights."

After reviewing this statutory scheme, the federal court in *Asarco* concluded that "while the Business Corporation Act permits changes of voting rights as between classes or series of stock, it does not permit an amendment under section 7–2 which would redistribute voting power within a class or series."

According to the court in *Asarco*, the issuance of stock that has this effect "would be *ultra vires* and void."

Asarco rejected as *ultra vires* the Asarco board's amendment of the certificate of incorporation providing for issuance of Series C preferred stock. The purpose of issuing the new stock was to prevent a takeover.

The amendment adopted by the board provided that a dividend of 1/10 of a share of Series C for each share of common be issued to all common shareholders. Initially in that case Series C shares possessed no voting rights except on matters related to preferential rights. However, if any shareholder became the beneficial owner of more than 20 percent of either Asarco's common stock or its Series C, then each 1/10 of Series C owned by anyone other than the 20 percent holder would have five votes in all matters submitted to common stockholders.

The Series C shares owned by the 20 percent holder would have no voting rights.

Judge Debevoise reasoned that "Asarco's board created a situation where the same class of stock will have different voting rights. This can be viewed as occurring with respect to two classes of stock.

The new preferred will have differing voting rights depending on whether it is held by a 20 percent holder. The new preferred is piggy-backed onto the outstanding common stock, and therefore there has also been created a situation in which certain common stockholders,—those who acquire 20 percent of the shares,—will have their voting power diluted five-fold vis-a-vis the other common stockholders. This is to be distinguished from a situation where a new class of stock has superior voting rights to all common stockholders or to all stockholders holding some other class."

Judge Debevoise concluded that while the Business Corporation Act of New Jersey permits changes of voting rights as between classes or series of stock, it does not permit an amendment under section 7–2 which would redistribute voting power within a class or series of stock.

In so concluding Judge Debevoise expressly found that a decision by the Delaware Supreme Court, *Baker v. Providence & Worcester Co.*, 378 A.2d 121 (Del. 1977), upholding an original certificate of incorporation with a class of stock with differing voting rights, would not be followed in New Jersey. He relied on the reasoning of the Delaware Chancery Court

in *Telvest Inc. v. Olsen*, slip op. # 5798 (3/8/79) [Available on WESTLAW, DE–CS database] which found a common stock dividend that in effect altered the voting rights of the common shareholder with regard to certain business conditions, and which was issued without shareholder approval, to be impermissible.

Defendants have argued that the application of *Asarco* to the NLI rights plan is inapposite. Because *Asarco* only involved voting rights of a class of stock, its reasoning should not extend to the NLI rights plan, according to the defendants.

They assert that Section 14A:7–7 of the New Jersey Business Corporation Act and not 14A:7–1 is applicable to the NLI plan. Section 14A:7–7 authorizes corporations to issue rights to purchase shares of stock from the corporation "for such consideration, and upon such terms and conditions as may be fixed by the board."

The defendants assert that there is nothing in that section, 14A:7–7, that prohibits the terms and conditions fixed by the board from being discriminatory.

I do not accept that broad reading of 14A:7–7. Such a reading would allow the boards of directors of corporations to circumvent the provisions of 14A:7–1. It is axiomatic that one cannot read one section of a statute to accomplish an end that is impermissible under another section of the statute.

It is interesting to note in reviewing various of the rights plans that have in various contexts been proposed that many of their essential elements are the same, and there seems to be an immediate return to the drawing board when a given type of rights plan, such as the one in *Asarco*, has been found not to pass muster, for purposes of redesigning around the prohibiting decisions.

The basic arithmetic in *Asarco* and in the NLI plan is the same. Given a trigger, there suddenly exist votes that did not exist before which have the effect of upsetting normal corporate structure.

I have some further reservations concerning the applicability of 14A:7–7 to NLI's rights certificates. Those rights certificates or those rights were initially issued as a dividend to common shareholders. It is axiomatic under the laws of New

Jersey, certainly, and most other jurisdictions, that dividends paid to shareholders of a class must be the same to each shareholder. What this plan does is effect a transposition of these dividends and of their meaning both when a first and second triggering event has occurred.

The 20 percent shareholder, and all other shareholders, received a dividend. Once there is a second trigger what they received changes in value according to whom the shareholder is. I do not believe that this is permissible, but I do not only rely on this.

What the plan also provides is that once these dividends have been received and somebody acquires 20 percent of NLI's common stock, certificates issue, which do not partake of the nature of the dividend that was originally paid. The certificates in the hands of the acquirer differ from those in the hands of all other shareholders. The certificates received by all shareholders, other than the acquiring shareholder, have no legend. The certificates received by the acquiring shareholder have a legend warning that they may be void or voided. The nonacquiring shareholders have therefore received through this dividend something which theoretically, at

least, is transferable. The 20 percent shareholder has received something which in all probability could under no circumstances be transferred.

Agnew v. American Ice Company, 2 N.J. 291, 66 A.2d 330, 335 (1949), stated that it is fundamental that in the declaration of dividends "arbitrary discrimination ... is inadmissible ... as to members of the same class." See *Klein v. Greenstein*, 24 N.J.Super. 348, 94 A.2d 497 (1953), *Scott v. Lorillard Co.*, 108 N.J.Eq. 153, 154 A. 515 (1931). Such discrimination did occur here.

I find *Asarco's* analysis and its conclusions quite apt in application to the dividends involved in the NLI rights plan. In *Asarco*, new preferred stock with possible voting provisions to be triggered in the future were piggy-backed onto the Asarco common stock, and when triggered, would create a discriminatory dilution in the voting power of a 20 percent common stockholder.

The rights issued to the common shares in NLI were piggy-backed onto those shares, and upon a triggering event they would have the effect of diluting the voting power and the equity of the 20 percent shareholder.

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I do not see that the transferability of those certificates, once the certificates themselves were issued, changes this except that it creates more dire a situation because it promises a dilution with respect to not only the voting power and the equity of the 20 percent shareholder, but also of all other common shareholders who have advertently or otherwise transferred their rights prior to the second trigger.

In *Minstar Acquiring Corporation v. AMF,* Judge Lowe relied on the *Asarco* case in analyzing a rights plan. She found that a rights plan, where nontransferable rights which were issued to shareholders of the same class discriminated against some of those shareholders, was invalid under New Jersey law.

The cases to which the defendants have directed me for authority that the flip-in provision is legal have not persuaded me.

Defendants argue that *Treadway,* which is a Second Circuit case, correctly enunciates New Jersey law and confirms that New Jersey law permits a New Jersey corporation to adopt discriminatory devices even where the purpose is to deter a takeover. *Treadway* was not this case.

Appendix A

The plaintiff in *Treadway* challenged the board's sale of 230,000 shares of newly issued common stock to a white knight, thereby diluting plaintiff's interest in Treadway and deterring a hostile takeover.

The sale in *Treadway* had the same effect, so far as voting rights are concerned, on the plaintiff who was proposing to take over, and on all other shareholders. It had, furthermore, no dilution effect so far as equity is concerned.

In the NLI rights plan there is a discrimination between shareholders and it is only the acquiring person's voting power and equity which is diluted aside from the inadvertent dilution with respect to shareholders who have transferred their rights.

Similarly the rights plan challenged in *Moran v. Household* did not contain a provision for voiding certain rights and increasing others. It entitles stockholders to one right per common share, which right on a merger would entitle the rights-holder to purchase $200 worth of common stock of the acquiring company for $100. Nor is *Dynamics Corporation* controlling of the issue before me since that relies expressly on Delaware law.

I do want to return to *Moran* because the defendants have relied so strongly on *Moran*, a decision of the Delaware Supreme Court, as being the bellwether in this area of defensive rights plans.

In *Moran* the familiar outlines of so many of these rights plans was seen in the sense first that there was a trigger when 20 percent of the company's stock was acquired or when a tender was made for 30 percent. Each right issued was a right to 1/100th of a preferred share.

There was in that case, so far as I can see, only a flip-over. If there was a merger, the person holding the preferred was entitled to buy $200 worth of the common stock of the acquiring company for $100.

The *Moran* court dealt at some length with the business judgment exercised by the directors, but it first addressed the question of whether the directors could adopt the plan, whether they had the power to adopt the plan. *Moran's* answer was yes.

It was argued by the tender offeror in that case that the rights plan at issue was not authorized by any provision of Delaware corporate law. The court found that

it was authorized by the Delaware equivalent of New Jersey corporate law 14A:7–7. It was also argued that the board was not authorized to usurp the shareholders' rights to receive hostile tender offers and that the board was unauthorized or not authorized fundamentally to restrict the shareholders' rights to conduct a proxy contest.

It also dealt with what it characterized as a sham argument, the argument that the right was designed never to be exercised. The court in *Moran* said the right could be exercised upon the happening of a triggering event. In this case the right never can be exercised. Obviously the first trigger can be pulled because it has been pulled. The Simmons' interests are a 20 percent interest. The first trigger has been pulled, but if anything is clear from the materials that have been submitted on this motion, and indeed from the colloquy from both sides and the argument on this motion, no tender offeror will ever offer in the face of this rights plan.

The defendant has conceded this: if this plan is found to be valid no one will tender, and that means that no one will tender this year or next year or at anytime between now and May 30, 1996.

The preferred stock provided for in the NLI plan is "out of the money"; no one expects that anyone will exercise a right to the preferred stock. The other rights spelled out in the rights plan here can never be reached because no one in his right mind will ever tender in the face of this plan.

The court in *Moran*—and I regard this as a key distinction between what was before that court and what what is before this court—stated "we do not view the rights plan as much of an impediment on the tender offer process."

It was argued to the *Moran* court that the board of directors was not authorized to usurp the stockholders' right to receive tender offers by changing Household's fundamental structure. And the court said that it concluded "that the rights plan does not prevent stockholders from receiving tender offers and that the change of Household's structure was less than that which results from the implementation of other defensive mechanisms upheld by various courts."

My conclusion and finding in this case is that the rights plan does prevent stockholders from receiving tender offers and the

change of NLI's structure, which at least theoretically would be effected by this rights plan, is more extreme than any that have been analyzed in other cases.

The *Moran* court, in upholding the rights plan before it, concluded that there were many ways around that plan. It suggested that the tender offeror could tender with a condition that the board redeem the rights. Well, that was a possibility in this case, and indeed the tender offeror in this case did request the board to redeem the rights and the board refused. At this stage the 20 percent trigger having been pulled, the board has no power for the next ten years to redeem the rights.

A second possibility that the court in *Moran* saw to circumvent the plan was to tender with a high minimum condition of shares and rights to be submitted. I haven't worked out the precise arithmetic of it, but in this case such a tender would be in the neighborhood, I believe, of requiring a 95 percent return, so high that it is "out of the money".

The next possibility that the court in *Moran* saw was tendering, and soliciting consents to remove the board and redeem the rights. That is not a possibility in this case because the rights are not redeemable.

A fourth possibility that the court in *Moran* saw was that the tender offeror could acquire 50 percent of the common shares and cause the corporation to self-tender for the rights. That is not a possibility in this case.

The fifth possibility the court saw as a way around the rights plan in *Moran* was that the tender offeror could form a group of shareholders constituting, up to the 20 percent limit, constituting some 19.9 percent of the common stock and could then solicit proxies for consents to remove the board and to redeem the rights. Since the rights are not redeemable, that is scarcely a possibility here.

The *Moran* case was dealing with what is permissible and what is impermissible with respect to tender offers. Underlying that decision is an implicit and almost explicit assumption that Delaware law permits tender offers. The *Moran* court said that "when the Household board of directors is faced with a tender offer and a request to redeem the rights, they will not be able to arbitrarily reject the offer."

Now, in this case the board of directors did reject the offer. We are not currently considering the question of whether that

decision was an arbitrary one or not because the question of the judgment exercised is not presently before me. But we do have a situation before me where no tender offer is possible.

If this board of directors instead of adopting this rights plan had adopted a rule that no tender offers will be permitted, it would clearly be beyond their power, and yet that is the situation that exists today, that there is no tender offer possible by anyone within the next ten years.

In structuring the rights plan, the board of directors, advisedly or otherwise, abdicated future control or responsibility with respect to tender offers by simply making them impossible.

The *Moran* court also stated that the rights plan before it was no more of a structural change than any other defensive mechanism that might be adopted by a board of directors in the face of a hostile tender offer. The court said that the rights plan did not destroy assets and that it did not result in the outflow of money from the corporation, nor did it impair its financial flexibility.

With respect to this rights plan, the flexibility of the board is certainly impaired and the shareholders have no flexibility that the board does not have.

The *Moran* court also said that the plan before it did not dilute earnings per share and that there were no adverse tax consequences for the corporation or for its shareholders.

In this situation the plan certainly dilutes earnings per share so far as the acquirer is concerned. I cannot comment with respect to tax consequences.

The *Moran* court dealt with the claim that the rights plan before it altered structure more than do other defensive mechanisms because "it is so effective as to make the corporation completely safe from hostile tender offers." It found that claim was without merit.

In this case that sort of structural change has been effected. The corporation is completely safe from tender offers for ten years.

Defendants have argued that this whole problem was created by the plaintiffs in triggering the rights plan by buying up to

and through the 20 percent limit, and they argue since the plaintiffs created this situation that is now before the court, they cannot be heard to complain.

There was a prior decision that was made that made that trigger an irreversible trigger and that was the board's decision not to reserve the right to redeem with respect to a 20 percent shareholder.

I am faced now with a 20 percent shareholder who wishes to tender and cannot tender so long as this rights plan is in place and I will deal with it on that basis.

[2] I find that there is a probability of success on the merits so far as the plaintiffs' application to void the rights plan is concerned. I further find that there is irreparable harm to the plaintiff in that it cannot present to the shareholders of NLI, in any meaningful way, its offer so long as this rights plan is in place. If the rights plan stays in place, the plaintiff obviously cannot proceed. This is a disservice not only to the plaintiff, which constitutes irreparable harm, it is a disservice to the shareholders who are entitled to exercise their own value judgments with respect to the worth or lack of worth of the offer from these plaintiffs.

Beyond that, however, there is another consideration of irreparable harm and that is to the shareholders in the long run, quite irrespective of this particular set of plaintiffs.

There has not only been a chilling effect set down for ten years on the possibility of any tender offer with the beneficial effects that such offers may have with respect to the price of the stocks held by the shareholders, but the knowledge itself that there cannot be such a tender offer may have a chilling effect on the price of the stock.

There is irreparable harm to the plaintiffs and to the other shareholders because the plaintiffs' opportunity to carry through with its tender offer is currently being impeded by an unlawful device, to wit, the rights plan.

I will now deal with the motion for a stay or dismissal. I deny that motion.

I have jurisdiction over this case. There is venue in this court, there is a general obligation on a federal court to accept cases, and the rights plan itself is, I believe, governed by New York law. The defendant itself has argued in the course of this case that the laws of most jurisdictions with respect to rights plans are the same.

I consider myself and I certainly consider my Court of Appeals as adequate to interpret New Jersey law.

There is a lack of identity between the parties in this action and the parties in the New Jersey action, and the issues in the two actions are not the same.

Based on these findings and conclusions the defendants NL Industries Inc. and its directors, agents, employees, and each of them are preliminarily enjoined from taking any steps, including the distribution of rights certificates, to implement or otherwise utilize the rights plan adopted April 23, 1986 pending final adjudication in this matter.

Appendix B—Oral Opinion of the District Court in *The Amalgamated Sugar Co. v. NL Industries, Inc.*

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

THE AMALGAMATED SUGAR CO., LLC CORP.,
LN PARTNERSHIP and NL ACQUISITION CORP.,

Plaintiffs,

v.

NL INDUSTRIES, INC., *et al.*,

Defendants.

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86 Civ. 5010 VLB

March 18, 1987
11:20 a.m.

Before:

HON. VINCENT L. BRODERICK,
District Judge

APPEARANCES:

KIRKLAND & ELLIS
Attorneys for Plaintiff Amalgamated
THOMAS A. GOTTSCHALK
YOSEF J. REIMER

TOWNLEY & UPDIKE
Attorneys for Plaintiffs
JAMES K. LEADER

KAUFMAN MALCHMAN KAUFMANN & KIRBY
Attorneys for Richard Rothenberg
IRVING MALCHMAN

DORSEY & WHITNEY
Attorneys for Defendant NL-Industries
JOHN G. RAINEY, JR.

(case called—all sides ready)

THE COURT: The plaintiffs seek a permanent injunction. They seek to enjoin the prosecution in Rothenberg v. The Amalgamated Sugar Company, New Jersey Superior Court, Chancery Division, of the question as to whether the adoption by the board of directors of NL Industries, Inc., of a preferred share purchase rights plan was ultra vires as a matter of New Jersey law.

I have considered, in preparing my disposition of the matter presented, the proceedings before me—the very extensive proceedings before me—in this action last summer. I have considered the briefs, the exhibits and the affidavits that have been submitted in connection with this application and the testimony that was elicited in connection with this application. What I have to say will constitute my findings of fact and my conclusions of law.

On June 25, 1986, The Amalgamated Sugar Company and its affiliates brought an action in this court entitled Amalgamated Sugar Co. v. NL Industries, Inc. In that action, they sought a declaratory judgment that the board of directors of NL Industries, Inc., had engaged in ultra vires conduct by adopting a specific preferred share purchase rights plan. The plaintiffs also sought an injunction against the operation of that plan.

A few days later, Amalgamated commenced an all-cash tender offer for shares of NL stock.

NL and 12 of its 13 directors were named as defendants in the action brought by Amalgamated. The defendants vigorously defended the action of the directors in adopting the preferred share purchase rights plan. Over a fairly concentrated period, there was extensive discovery and I held several lengthy arguments and hearings. Those hearings pertained to various motions, and two of them focused directly on the question of the validity or the invalidity of the purchase rights plan.

I am satisfied that the documents submitted and the hearings had developed every detail that was pertinent to resolution of the matter presented.

On August 5, 1986, I preliminary enjoined the NL preferred share purchase rights plan, holding that it was "An unlawful device," and was "Ultra vires as a matter of New Jersey business corporation law."

I did this by way of an oral opinion which has since been memorialized in 644 F. Supp. 1229 to 1240. I denied motions by NL to stay my ruling pending an appeal and to enjoin Amalgamated from buying stock pursuant to its outstanding tender offer.

On August 6, 1986, Judge Pierce, of the Second Circuit Court of Appeals, denied NL's application for a stay of the preliminary injunction but enjoined Amalgamated from purchasing shares pursuant to its tender offer.

The tender offer expired on August 7, 1986, at 5 p.m. NL sought an injunction to bar Amalgamated from purchasing NL's stock on the open market. By order dated August 8, 1986, Judge Pierce denied the application.

Amalgated then purchased 14 million shares on the open market. These shares, together with Amalgamated's earlier purchases, put Amalgamated in the position of owning 51% of NL's stock.

Operational control of NL did not pass to Amalgamated at that time. At that stage, NL's 13-member board of directors was intact and was still operating NL. The terms of the members of this board of directors were staggered so that it would be some time—I believe two years—before Amalgamated would be in a position to assert control through a board of directors that contained a majority which Amalgamated had played a role in selecting. None of the members of the NL board as of August 13 was affiliated with Amalgamated. Only one member of that 13-member board

was involved with the management of NL; the other 12 members had no affiliation with NL other than their affiliation as directors.

At some stage between August 8 and August 13, various representatives of Amalgamated and NL met to explore the possibility of settling the case. A proposed settlement agreement was developed, and on August 13, 1986, the boards of directors of both NL and Amalgamated voted to approve that settlement agreement. Thus, the settlement was approved by persons who had adverse interests. Although I do not recall any evidence to that effect, it is reasonable to infer no member of the Amalgamated board had any affiliation with NL other than the status of Amalgamated and its affiliates as stockholders. The NL board had no member with any affiliation with Amalgamated.

At this time, 12 of the 13 NL directors were defendants in Amalgamated's action. By the terms of the settlement agreement, nine of the NL directors were to lose their positions on the NL board.

On August 14, 1986, I was advised that the parties had agreed to terminate the litigation before me. By stipulation, the action was dismissed with prejudice as to the 12 directors of NL. Amalgamated moved to convert the outstanding preliminary injunction into a final judgment. I was notified that there was no opposition to this application, and on August 14, 1986, a final judgment was entered which provided:

"1. The preferred share purchase rights plan adopted by the board of directors of NL Industries, Inc., on April 23, 1986, is declared invalid, null and void; and,

"2. Defendant NL Industries, Inc., is permanently enjoined from taking any steps to implement or otherwise utilize the preferred share purchase rights plan adopted by the board of directors of the company on April 23, 1986."

I would note that the settlement agreement between Amalgamated and NL provided that the NL board of directors would remain in charge of the litigation on behalf of NL until it was terminated.

On August 1, 1986, a letter was sent to me by Richard Rothenberg, a NL shareholder, transmitting the draft of a complaint which he planned to file in the state court of New Jersey which would seek, inter alia, a declaratory judgment as to the validity of NL's preferred shares purchase rights plan under New Jersey law.

Mr. Rothenberg did not seek to intervene in the proceedings before this court.

On August 6, 1986, which was one day after my decision preliminarily enjoining utilization of the rights plan, Mr. Rothenberg filed an action in New Jersey entitled Rothenberg v. The Amalgamated Sugar Company, et al.

The relief sought in that action included the following: a direction to NL to distribute the preferred rights to shareholders immediately, or, alternatively, awarding those shareholders damages as a result of NL's failure and refusal to distribute those rights to them. He also sought a declaration that the rights were valid under New Jersey law and other relief which was premised upon the validity of the preferred share purchase rights plan.

Amalgamated moved for summary judgment in the Chancery Division of New Jersey Superior Court, asserting that the Rothenberg suit was barred by principles of res judicata and full faith and credit. Judge Levy of that court denied the motion without prejudice.

Amalgamated sought leave to appeal from the Appellate Division of the Superior Court, and leave to appeal was denied.

Appendix B

On March 4, Amalgamated applied to this court for an order to show cause why this court should not enjoin the prosecution of the New Jersey action. The rationale of the application was that the relief sought was necessary to protect and effectuate the final judgment in this action. Amalgamated also sought a temporary restraining order prohibiting further prosecution of the action in New Jersey pending a ruling on the application to this court for injunctive relief.

After hearing the parties, this court issued the order to show cause and granted Amalgamated's application for a temporary restraining order.

Further proceedings were had in this court on March 13, 1987, after which the temporary restraining order was continued and I reserved decision until today.

The application to this court is for a permanent injunction, an injunction which will prohibit Mr. Rothenberg from pursuing in New Jersey an action which puts into question the validity of the preferred share purchase rights plan, which, in my opinion of August 5, 1986, I found to be ultra vires and null and void.

I am satisfied that I have before me now all of the facts which I need to have to determine Amalgamated's application.

Stated briefly, it is Amalgamated's position that the matter of the validity of the rights plan has been vigorously litigated and definitively decided, and that it should not have to relitigate that issue in another forum. Relitigation will certainly be expensive for both Amalgamated and NL, and, so far as NL is concerned, will involve the expenditure of corporate assets.

Moreover, Amalgamated argues that the pendency of the issue in New Jersey places in limbo various steps which could be taken by NL and by Amalgamated which would be

in the interest of each of them: tranfers of assets, intercorporate loans, et cetera.

While the New Jersey action pends, according to Amalgamated, the spectre of the rights plan severely limits any constructive intercorporate plan.

The reason for this hiatus is that the rights plan, which this court found illegal, contains various punitive provisions which could be triggered by a whole litany of intercorporate transactions, and the springing of that trigger could have the effect, so far as Amalgamated is concerned, of adversely affecting its voting rights and substantially reducing the value of its investment in NL.

It is the position of Mr. Rothenberg that he was not a party to the litigation between NL and Amalgamated and that he cannot be bound by a judgment such as that rendered on a consent basis in this case to which he was not a party.

He argues, moreover, that the settlement itself which resulted in the consent judgment was collusive, since at the time of the settlement Amalgamated was, for all practical purposes, in control of NL.

He further argues that this court had no power to issue the final judgment since there was at that stage no case or controversy.

He further argues that it is now March 18, that his action in New Jersey was filed on August 6 of 1986, and that laches proscribe Amalgamated's application here.

He urges that there is no res judicata effect which could be given to this court's judgment vis-a-vis the New Jersey action since he was not a party to the action in this court.

Moreover, Mr. Rothenberg points to the decision of Judge Levy in New Jersey denying an application by Amalgamated and NL for summary judgment as itself having res judicata

effect which will preclude this court from considering Amalgamated's present application.

We will take a 5-minute recess.

(Recess)

THE COURT: I am going to deal first with the arguments of Mr. Rothenberg, but I want to note first the impact which the United States Supreme Court opinion of Parsons v. Steel, 106 S. Ct. 768 (1986), has on the matter before me.

Parsons v. Steel would require this court to give res judicata effect to any judgment of the New Jersey court on the subject of the validity of the preferred rights plan. If, therefore, this court were to deny the application and a decision was made by the New Jersey court that the preferred rights plan was valid and should be effective, that decision would have res judicata effect.

There are laches so far as Amalgamated and NL are concerned. In the New Jersey action, they presented this court's opinion and judgment, and they sought from the New Jersey court summary judgment on the basis of res judicata.

Judge Levy denied that application and suggested that the next step would be a motion for summary judgment on the merits. He made it perfectly clear that he was not ruling on the merits and that his ruling, depending on what was presented to him, could be in favor of either party.

After that, and after the application for leave to appeal was denied, Amalgamated came back to this court.

It was entirely appropriate for that initial application to have been made in the New Jersey action. There is a continuing sensitivity in the relationships between federal and state courts, and it was entirely appropriate and in the interest of comity to apply first to the state court for a finding

that this court's opinion and judgment had res judicata effect before application was made to this court.

I would note that the evidence before me is to the effect that there has been very little progress in the New Jersey action, aside from the litigation with respect to res judicata and a single discovery request by the plaintiff which has not yet been complied with. It is a very early stage in that litigation.

Judge Levy's denial of the motion for summary judgment was without prejudice. Since Judge Levy made it clear that he still has on open mind on the substantive issue, it is difficult to see what res judicata could attach to it.

I also reject Mr. Rothenberg's argument that at the time of settlement and at the time that the final judgment issued there was no case or controversy or there was collusion.

I have rarely, in 10 years on the bench, seen a matter as vigorously and effectively contested as that of the validity of the preferred rights plan. I am persuaded that there is no evidence that could have been adduced on that subject which was not presented in the course of the litigation last summer and the significance of which was not fully elucidated.

The settlement came at a time when both sides, plaintiffs and defendants, were looking forward to months and perhaps more of continued expensive and exhaustive litigation. That litigation would, without question, have been a financial drain on all parties, and it would have diverted the attention of plaintiffs and defendants from the business of productively running NL.

There comes in many cases a time when settlement is indicated as the wisest course. Settlement is arrived at through negotiation, and settlement may be and often is directed towards the production of a final judgment, as it was in this case.

Settlement negotiations do not constitute collusion, and a consent judgment, which is produced as a result of those negotiations, is not suspect and, other things being equal, is entitled to full faith and credit.

The settlement agreement itself provided that the NL board of directors would be in control of the litigation on behalf of NL until final judgment.

I find that until the final judgment was signed, there was a case or controversy before me.

Mr. Rothenberg's argument that he was not a party to the prior action is based upon solid fact; he was not a party to that action. I shall discuss the significance or lack of significance of that in a few moments.

I find that there will be irreparable harm so far as Amalgamated is concerned if the relief sought here is not granted. That harm will be (1) the expense of carrying on further litigation with respect to an issue which Amalgamated was justified in thinking had been decided by this court. Those litigation expenses will be considerable, and it is unlikely that a single shareholder owning 100 shares is going to be in a position to compensate for those expenses if that ultimately were to be indicated.

(2) The more substantial harm is, however, the one that I have already reviewed. During the pendency of the New Jersey action, both Amalgamated and NL will be seriously impeded in the conduct of their business affairs with the potential in the future that the rights plan might be resurrected. Each company would have to avoid vis-a-vis the other any merger, asset transfer, loan, or tax saving arrangement that would trigger the punitive effects of the rights plan.

There are, of course, other shareholders in NL besides Amalgamated and Mr. Rothenberg The evidence before me is that since the final judgment in this action 12.8 million

shares of NL common stock and 31 million shares of series C preferred stock have been traded. If the shareholders who sold those shares kept themselves informed, the sales would have taken place with the knowledge that the preferred rights plan had been enjoined.

Since the rights plan, if effective, would have made available to those shareholders certain very valuable rights upon the happening of various contingencies, the harm to them if the rights plan were to be resuscitated must also be taken into consideration.

The courts themselves have an interest here, and that is an interest in finality. This court has a burgeoning case load and I suspect the same is true of the court in New Jersey, and it is certainly in the interest of the continued viability of the judicial process that duplicative litigation be avoided.

THE COURT: I think we will adjourn until 2:15, if that is agreeable.

MR. GOTTSCHALK: Certainly, your Honor.

(Luncheon recess)

AFTERNOON SESSION

2:30 p.m.

THE COURT: In seeking to invoke the injunctive powers of this court, plaintiff relies upon 28 U.S.C. Section 1651 and 28 U.S.C. Section 2283.

Section 1651(a) provides that "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law."

Section 2283 provides: "A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where

necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

What 1651 means is that in appropriate cases this court may issue a writ.

Section 2283 proscribes injunctions with respect to proceedings in a state court with various exceptions, including an exception for where such an injunction is necessary in aid of a court's jurisdiction or is necessary to protect or effectuate its judgments.

I am asked to apply Section 2283 in this situation on the basis that, in effect, res judicata principles apply, and that the opinion of this court and the final judgment of this court has res judicata effect with respect to the relief which is sought by Mr. Rothenberg in the New Jersey court. (The distinctions between res judicata and collateral estoppel have not been developed in this expedited proceeding before me.)

For res judicata to apply to a judgment, there must be a final judgment on the merits; there must be identical issues in the two actions involved, the action with respect to which res judicata is invoked and the action against which it is invoked. In other words, the issues presented in the second action must necessarily have been raised in the first action.

A third requirement is that the party against whom res judicata is asserted in the later action must either have been a party in the prior action or in privity with a party in the prior action, Kreager v. General Electric Company, 497 F. 2d 468, 471 (2d Cir.), cert denied, 419 U.S. 861 (1974); Zdanok v. Glidden Company, 327 F.2d 944 at 955, (2d Cir.), cert denied, 377 U.S. 934 (1964).

I shall take up those requirements one-by-one.

First, the requirement that there be a final judgment on the merits:

Final judgment may mean different things in different contexts, and Judge Friendly drove this point home to us in Lummis Company v. Commonwealth Oil Refining Company, 297 F.2d 80, 89 (2d Cir. 1961) cert denied, 368 U.S. 986 (1962).

Judge Friendly pointed out that there is "growing disposition to enlarge the scope of res judicata and to place more regard on the substance of the decision than on the form of the proceedings." He was quoting there from a Kansas Supreme Court decision in Board of County Commissioners v. McIntosh, 30 Kan. 234, 238, 1 Pac. 572, 575 (1983).

Judge Friendly went on to say that "whether a judgment not 'final' in the sense of 28 U.S.C. Section 1291 ought nevertheless be considered 'final' in the sense of precluding further litigation of the same issue turns upon such factors as the nature of the decision (i.e., that it was not avowedly tentative), the adequacy of the hearing and the opportunity for review. 'Finality' in the context here relevant may mean little more than that the litigation of a particular issue has reached such a stage that a court sees no really good reason for permitting it to be litigated again." Id.

My opinion on the validity of the rights plan was a final opinion. On the basis of that opinion I issued a preliminary injunction. It cannot be suggested, however, that anything further would have been presented in a plenary trial that would have made material or facts available to me that might have caused a redirection or an is an amplification of that opinion. The opinion was predicated upon a careful analysis of all the information that very competent counsel on both sides over a period of weeks were able to draw to my attention.

On that issue, quite apart from other issues in the litigation before me which were left for another day, there was nothing further that I would have been willing to

receive, because, quite simply, I am persuaded that counsel on both sides exhausted their coffers.

The decision was not an "avowedly tentative" one. To the contrary, it was, even though oral, a very carefully structured opinion. The hearing which preceded it and upon which it was based were quite adequate.

The question of the validity of the preferred share purchase rights plan had been at the time of that opinion litigated to such a fare-three-well that in the words of Judge Friendly, I see "no really good reason for permitting it to be litigated again." 297 F.2d at 89.

Now, the second requirement to be considered with respect to res judicata is that the issues to be decided in the second action are identical to those that were necessarily decided in the first action.

The basic issue presented to me last August was that of the validity under New Jersey law of the preferred share purchase rights plan.

The posture in which it was presented was that the plan was in place and had been put in place by the NL directors and the plaintiffs were urging its invalidity under New Jersey law and seeking to enjoin its application.

Mr. Rothenberg, in New Jersey, seeks the same relief. The posture in that action is that Mr. Rothenberg is urging the validity of the preferred rights plan under New Jersey law and is seeking from the New Jersey court a declaratory judgment as to that plan's legality. In fact, all the relief that Mr. Rothenberg seeks in New Jersey is postulated upon the finding he seeks that the rights plan is valid.

Thus, the issue before me and the issue in New Jersey are identical ones. Before me, it was decided that the rights plan is illegal and its employment was enjoined. In New Jersey, Mr. Rothenberg seeks a declaration that the plan is valid,

and he seeks relief which is predicated upon a finding of validity.

The third res judicata requirement is that the party in the later action against whom res judicata is asserted must be the same party as the party in the prior action, or must be in privity with that same party.

The only difficult part of the problem that has been presented to me is that third requirement. There are cases—and they have been cited to me by the defendant, Mr. Rothenberg—which say that a shareholder is not in privity with his corporation. There are cases—and they have been cited to me by the plaintiff—which say that the shareholder is in privity with his corporation.

Analysis of these various cases—and I see no reason to cite them right now because counsel know which they are—indicates that neither group is very helpful in resolving the problem before me. Those cases relied upon by plaintiff seem generally to involve shareholders who are in a controlling position in the corporation and who actively participated in the prior litigation.

The cases cited by Mr. Rothenberg generally involve claims for damages and the principle that a person who is not a party to a litigation will not be held to what happened in that litigation when his own person or property is put at risk in a later litigation.

What all of these cases do suggest to me is that inquiry must be made into the precise relationship of the parties to one another and the precise relationship of each of the parties to what is involved in the litigation to which he is a party.

I have found most helpful in this connection a case called Southwest Airlines Company v. Texas International Airlines, 546 F.2d 84 (5th Cir.) cert denied, 434 U.S. 832 (1977).

That case deals with the concept of privity. It also deals with a concept which I have not previously discussed called virtual representation, and it suggests to me that rather than searching through prior cases for one that fits the facts of this case, an analysis of what was before the directors and what is presently before Mr. Rothenberg will be more helpful.

In the prior litigation, the litigation before me, Amalgamated made a frontal attack upon the rights plan. The defendants, NL, and its directors vigorously defended that plan. They vigorously defended the right of the board of directors elected by the shareholders and charged with the governance of the corporation by the shareholders to adopt that specific rights plan in what they claimed was the interest of the shareholders.

Certainly, a mere reading of the rights plan which was in place at that time makes it clear that its purpose was to protect individual shareholders or smaller corporate shareholders against what the board of directors perceived as being possibly overreaching tender offerors.

Every argument that could have been presented to justify the validation of the rights plan was presented by the defendants in their case. Their activities were certainly directly in the interests of shareholders other than Amalgamated and its affiliates and were intended so to be.

I reach back to what was before me during the course of that earlier litigation to say that the shareholders were kept informed of developments with respect to the rights plan and of developments in the course of the litigation.

Mr. Rothenberg specifically knew of that litigation and knew of the developments in the course of that litigation. While it was still active, as I had previously noted, he wrote to me with a copy of his proposed complaint in New Jersey.

There is nothing with respect to this rights plan that Mr. Rothenberg will be able to present in the New Jersey action

which was not before me. Moreover, with respect to the validity of the rights plan itself, his position in the New Jersey action will necessarily be identical to the position that NL and its directors took in the action before me.

If Mr. Rothenberg were to be successful in persuading the court in New Jersey that under New Jersey law the rights plan that I have found invalid under New Jersey law is valid under New Jersey law, he would be establishing nothing more than the corporation and the directors attempted to establish in the action before me. Without making a finding, therefore, that there is privity in any technical sense between Mr. Rothenberg, as a shareholder, and the directors of NL, and without making a finding that those directors virtually represented Mr. Rothenberg, I do find that every interest which Mr. Rothenberg could possibly have had in the establishment of the validity of the rights plan was pressed before me as vigorously as it could be pressed.

I find, further, that Mr. Rothenberg had no interest in the rights plan which could be presented to the court in New Jersey that was not presented to me by those who sought to uphold the plan before me, to wit, the corporation, NL, and its directors.

Under the circumstances of this case, which is, in my judgment, unique among those that have dealt with this problem, the provisions of Section 2283 have very direct application. A judgment was issued by this court. On the basis of that judgment, two corporations and their shareholders have conducted business for a period of some seven months. There has been a shadow over the conduct of that business by reason of the pendency of the New Jersey action. The pendency of that action is a threat to the effectuation of the judgment which was rendered in this case.

Judge Wisdow, in the Southwest Airlines case, analyzes the importance of the principle of res judicata. He said, "The principle of res judicata serves several policies important to our judicial system. By declaring an end to litigation,

the doctrine adds certainty and stability to social institutions. This certainty, in turn, generates public respect for the courts. By preventing relitigation of issues, res judicata conserves judicial time and resources. It also supports several private interests, including avoidance of substantial litigation expenses, protection from harassment or coercion by lawsuit, and avoidance of conflicting rights and duties from inconsistent judgments." 546 F.2d at 94.

Now, every one of those policies is involved in the question which is before me, and if relitigation were allowed in this case it would certainly defeat those policies. There would be uncertainty with respect to the operation of the business of two corporations and with respect to the holdings of shareholders in one of those corporations. There would inevitably be a reduction in respect for the courts if an issue once definitively ruled upon were submitted for further judicial consideration. It would certainly continue to waste judicial resources. There would be the expense, which I discussed, of further litigation.

If I could identify a single issue which was peculiar to Mr. Rothenberg or to shareholders in Mr. Rothenberg's position which had not in the course of the presentations before me been fully considered, I might not be as willing as I am to say that this is a case to which the principle of res judicata must be made applicable.

I grant Amalgamated's application for a permanent injunction enjoining Mr. Rothenberg, his agents, servants, employees and attorneys and those persons in active concert or participation with them from seeking, in Rothenberg v. Amalgamated Sugar Company, or in any other action, relief premised upon the asserted validity of NL's preferred share purchase rights plan.

* * *

Appendix C—Opinion of the Second Circuit in *Rothenberg v. The Amalgamated Sugar Co., Inc.*, 825 F.2d 634

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1325—August Term 1986

Argued: June 17, 1987 Decided: July 28, 1987

Docket No. 87-7287

THE AMALGAMATED SUGAR COMPANY, LLC CORPORATION and LN PARTNERSHIP,

Plaintiffs-Appellees,

—against—

NL INDUSTRIES, INC., ROBERT A. BICKS, NICHOLAS F. BRADY, MAURICE F. GRANVILLE, WILLIAM A. MARQUARD, JAMES F. MATHIS, THEODORE C. ROGERS, IAN M. ROSS, HERMAN J. SCHMIDT, ROBERT G. SCHWARTZ, DONALD V. SEIBERT, ELEANOR B. SHELDON, and THOMAS P. STAFFORD,

Defendants-Appellees,

RICHARD ROTHENBERG,

Appellant.

Appendix C

Before:

OAKES, MESKILL, and PRATT,
Circuit Judges.

Appeal from an order of the United States District Court for the Southern District of New York, Vincent L. Broderick, *Judge*, entering a permanent injunction, pursuant to 28 U.S.C. § 2283, restraining Richard Rothenberg from relitigating, in the New Jersey courts, any action "premised upon the asserted validity" of NL Industries, Inc.'s preferred share purchase rights plan.

Affirmed.

THOMAS A. GOTTSCHALK, Washington, DC (Kirkland & Ellis, Frederick M. Rowe, Daniel F. Attridge, Jeffrey A. Rosen, Yosef J. Riemer, Washington, DC; Townley & Updike, James K. Leader, New York, NY, of Counsel), *for Plaintiff-Appellee The Amalgamated Sugar Company.*

Dorsey & Whitney, New York, NY (Richard L. Bond, John G. Rainey, Jr., of Counsel) *for Defendant-Appellee NL Industries.*

IRVING MALCHMAN, New York, NY (Kaufman, Malchman, Kaufmann & Kirby, of Counsel), *for Appellant*.

PRATT, *Circuit Judge*:

Richard Rothenberg, owner of 100 shares of NL Industries, Inc. ("NL"), appeals from an order of the District Court for the Southern District of New York, Broderick, *Judge*, entering a permanent injunction pursuant to 28 U.S.C. § 2283 enjoining Rothenberg from pursuing any action "premised upon the asserted validity" of NL's preferred share purchase rights plan ("purchase rights plan"), sometimes referred to as a "poison pill".

The district court granted the injunction because it found that (1) both the preliminary injunction it had granted earlier, *see Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F. Supp. 1229 (S.D.N.Y. 1986), and a final consent judgment it had entered, had established the invalidity of the purchase rights plan and were valid final judgments entitled to res judicata effect; (2) Rothenberg was raising, in New Jersey ligitation, the same claim that had been decided adversely to him in the district court; and (3) NL and its directors had adequately represented Rothenberg in the earlier litigation.

Rothenberg appeals. Because we agree that the final consent judgment entered by the district court is entitled to res judicata effect, we hold that the district court properly exercised its authority under § 2283 to enjoin relitigation in the New Jersey courts and affirm.

BACKGROUND

NL is a corporation, with its principal place of business in New York, that is engaged primarily in the oil service and chemical production businesses. *Id.* at 1231. Amalgamated Sugar is a Utah corporation with its principal place of business in Utah. The two other appellees, LLC Corp. and LN Partnership, are organized and exist under the laws of Delaware and Texas, respectively. Both have their principal places of business in Texas.

The litigation leading to this appeal began on June 25, 1986, when Amalgamated Sugar Co., LLC Corporation, and LN Partnership (collectively, "Amalgamated") sued NL and 12 of its directors in federal court, seeking a declaration that NL's purchase rights plan was invalid under New Jersey law and a preliminary injunction against its implementation. *See* 644 F. Supp. 1229 (S.D.N.Y. 1986). The effect of the purchase rights plan, which had been adopted by the NL directors on April 22, 1986, was, simply put, to dilute the voting power and equity of any acquiring shareholder whose holdings of NL common stock exceeded 20 percent. *See id.* at 1232-34. The plan reflected NL's concern that, because its shares were undervalued in the market, it was vulnerable to takeovers at less than adequate prices. *Id.* at 1231.

The validity of the purchase rights plan was crucial to Amalgamated because it was seeking to negotiate a cash merger with NL and had already acquired approximately 17 percent of NL's stock prior to filing suit. On July 3, 1986, after filing suit, it announced that it had acquired over 20 percent of NL's common stock and commenced a tender offer for all of NL's shares, conditioned on judicial invalidation of the purchase rights plan.

A hotly contested litigation battle ensued in the district court, in which NL and its directors vigorously defended the validity of the purchase rights plan. The proceedings included extensive briefing, five lengthy hearings, and discovery that produced nearly 9,000 pages of documents. The evidence included depositions from 18 people, including the chief executive officers and chief financial officers of NL and Amalgamated, 16 affidavits, and courtroom testimony. Judge Broderick commented that he had "rarely, in ten years on the bench, seen a matter as vigorously and effectively contested", and that no additional evidence "could have been adduced on the subject" of the validity of the purchase rights plan.

Although NL shareholders, including Rothenberg, were notified of the litigation and of the attack on the purchase rights plan's validity, Rothenberg did not move to intervene but, through his counsel, wrote to Judge Broderick to inform the court that he planned to bring an action in the New Jersey state court seeking a declaration of the purchase rights plan's validity.

On August 5, 1986, the district court denied NL's motion to stay or dismiss on the grounds that the matter concerned New Jersey state law, and preliminarily enjoined NL and its directors from implementing or otherwise utilizing the purchase rights plan pending final adjudication of the matter. 644 F. Supp. at 1240. The court found that the purchase rights plan was *ultra vires* as a matter of New Jersey state law because it allowed discrimination among shareholders of the same class and series, *id.* at 1234, and because the plan effectively prevented stockholders from receiving tender offers. *Id.* at 1238.

On August 6, 1986, Rothenberg filed suit in the New Jersey state court against Amalgamated and NL, seeking to relitigate the validity of the purchase rights plan that had been declared invalid by Judge Broderick.

On August 8, 1986, Amalgamated purchased 14 million shares of NL on the open market, thereby obtaining a 51 percent interest in NL. Despite Amalgamated's acquiring a 51 percent interest in the company, NL's 13 member board of directors, all but one of whom were independent of NL management, remained intact and retained operational control of NL. Provisions in NL's certificate of organization prevented Amalgamated from electing a majority of NL's directors for at least two years.

In the wake of this extremely costly and arduous litigation, and faced with a substantial likelihood of ultimate defeat, the NL directors authorized NL to enter into settlement negotiations with Amalgamated, and on August 13, 1986, NL followed the advice of its highly qualified independent counsel and financial advisors and approved a settlement agreement. The effect of the agreement was to permit Amalgamated to nominate a majority of NL's board sooner than would otherwise have occurred, while providing important protections for NL's minority shareholders. Although Amalgamated agreed to maintain established benefit plans for certain NL employees, the agreement did not provide any benefit to the independent NL directors and, in fact, required that nine of the directors resign their board positions.

A crucial effect of the agreement was termination of the costly litigation between the parties. Absent entry of the final consent judgment, the purchase rights plan would have diluted Amalgamated's voting power from 51 percent to 12 percent and diluted its investment by hun-

dreds of millions of dollars. As the district court correctly found, both Amalgamated and NL would have been burdened with additional legal expenses and would have been "seriously impeded in the conduct of their business affairs" if the validity of the purchase rights plan remained litigable.

On August 14, 1986, the parties advised the district court of their agreement and the court granted Amalgamated's motion to convert its preliminary injunction into a final judgment and permanent injunction against implementation of the purchase rights plan.

On November 18, 1986, Amalgamated and NL filed a summary judgment motion on res judicata grounds in the New Jersey litigation. That court denied the motion without prejudice and indicated that it would not resolve the issue of the finality, for res judicata purposes, of the final consent judgment. Leave to take an interlocutory appeal was denied. Amalgamated then moved in the district court for a temporary restraining order and a permanent injunction, pursuant to 29 U.S.C. § 2283, against relitigation, in the New Jersey action or in any other action, of the validity of the purchase rights plan.

After a hearing at which Rothenberg appeared and argued through counsel, the district court entered a temporary restraining order prohibiting Rothenberg's relitigation, in conflict with the prior federal judgment, of the validity of the purchase rights plan. Following an additional hearing at which Rothenberg was again represented by counsel, Judge Broderick delivered an extensive oral opinion granting Amalgamated's motion for a permanent injunction. *Amalgamated Sugar Co. v. NL Industries*, Transcript of Oral Opinion, 86 Civ. 5010 (S.D.N.Y. March 18, 1987).

Noting that he was "satisfied that the documents submitted and the hearings had developed every detail that was pertinent to the resolution" of the issue of the validity of the purchase rights plan, *id.* at 3, Judge Broderick rendered comprehensive findings of fact and conclusions of law. He found that operational control of NL had not passed to Amalgamated prior to entry of the consent judgment, *id.* at 4, that the settlement agreement had been approved by persons with adverse interests, *id.* at 5, and that the settlement agreement itself had provided that the NL directors would remain in charge of the litigation on NL's behalf, *id.* at 13. On the basis of these facts, he concluded that there was a live controversy between the parties until the final judgment was signed. *Id.*

The district court exercised its power under 28 U.S.C. § 2283 to "grant an injunction to stay proceedings in a state court * * * where necessary in aid of its jurisdiction, or to protect or effectuate its judgments" because it concluded that the elements of res judicata—final judgment on the merits, identity of issues, and identity or privity of parties—were satisfied. *See* Transcript at 16-17. Relying on Judge Friendly's opinion in *Lummus Co. v. Commonwealth Oil Refining Co.*, 297 F.2d 80, 89 (2d Cir. 1961), *cert. denied*, 368 U.S. 986 (1962), the district court found that its opinion accompanying the preliminary injunction, 644 F. Supp. 1229, like the consent judgment it had entered, was a valid final judgment. *See* Transcript at 17-19. Second, the court found that an identical issue—the validity of the purchase rights plan—was being raised in the New Jersey court. *Id.* at 20. Finally, the court found that "every interest which Mr. Rothenberg could possibly have had in the establishment of the

validity of the rights plan was pressed before me as vigorously as it could be pressed", *id.* at 24, and that it was appropriate under the circumstances that the shareholder be bound by the actions of NL and its directors.

The court found further that the New Jersey court's denial of summary judgment was not itself a final judgment on the merits that would be entitled to res judicata effect, *see id.* at 10-11, and that both Amalgamated and NL would be irreparably harmed if the injunction did not issue. *See id.* at 13-14.

On this appeal, Rothenberg argues that by filing its motions for summary judgment in the New Jersey court, Amalgamated waived its right to seek relief in federal court; that the district court should have abstained from interfering with the state proceeding; that the prior consent judgment was not res judicata against the shareholder, Rothenberg; and that the preliminary injunction was not a final judgment and therefore not entitled to res judicata effect. Since none of these arguments has merit, we affirm.

DISCUSSION

28 U.S.C. § 2283 provides: "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." A district court may properly enjoin state court proceedings in order "to protect or effectuate its judgments" when it is necessary to preserve its authority or to avoid needless litigation. *See In re Baldwin-United Corp.*, 770 F.2d 328, 335-36 (2d Cir. 1985); *Browning Debenture Holders' Committee v.*

DASA Corp., 605 F.2d 35, 38 (2d Cir. 1978); *Samuel C. Ennis & Co. v. Woodmar Realty Co.*, 542 F.2d 45, 49 (7th Cir. 1976), *cert. denied*, 429 U.S. 1096, 97 S. Ct. 1112 (1977); *Sperry Rand Corp. v. Rothlein*, 288 F.2d 245, 249 (2d Cir. 1961). While the Anti-Injunction Act is designed to avoid disharmony between federal and state systems, the exception in § 2283 reflects congressional recognition that injunctions may sometimes be necessary in order to avoid that disharmony. *See Southwest Airlines v. Texas Int'l Airlines*, 546 F.2d 84, 91 (5th Cir.), *cert. denied*, 434 U.S. 832, 98 S. Ct. 117 (1977).

The exception in § 2283 applies when the state court proceeding would otherwise be barred by res judicata. *See In re Corrugated Container*, 659 F.2d 1332, 1335 (5th Cir. 1981), *cert. denied*, 456 U.S. 936, 102 S. Ct. 1993 (1982); *Browning*, 605 F.2d at 40; *Southwest Airlines*, 546 F.2d at 94 and n.30; *Ennis*, 542 F.2d at 49. In this case, the district court acted properly when it enjoined Rothenberg from pursuing a state court adjudication of the validity of the purchase rights plan because the district court's prior consent judgment, invalidating that plan, was entitled to res judicata effect.

Res judicata will preclude relitigation of a claim where the earlier decision was a final judgment on the merits rendered by a court of competent jurisdiction, in a case involving the same parties or their privies, where the same cause of action is asserted in the later litigation. *In re Teltronics Services, Inc.*, 762 F.2d 185, 190 (2d Cir. 1985). The doctrine was judicially established as a means to promote legal economy and certainty. *Expert Electric Co. v. Levine*, 554 F.2d 1227, 1232 (2d Cir.), *cert. denied*, 434 U.S. 903, 98 S. Ct. 300 (1977).

The general rule is that a final consent decree is entitled to res judicata effect. *SEC v. Randolph*, 736 F.2d 525, 528 (9th Cir. 1984); *Wallace Clark & Co. v. Acheson Industries*, 532 F.2d 846, 848 (2d Cir.) (citing, *e.g.*, *United States v. Southern Ute Indians*, 402 U.S. 159, 91 S. Ct. 1336, 28 L. Ed.2d 695 (1971); *Siegel v. National Periodical Publications, Inc.*, 508 F.2d 909, 913 (2d Cir. 1974); 1B Moore, Federal Practice ¶ 6.409 [5], at 1032 (2d ed. 1974)), *cert. denied*, 425 U.S. 976, 96 S. Ct. 2177 (1976). This is so because the entry of a consent judgment is an exercise of judicial power, *Pope v. United States*, 323 U.S. 1, 12, 65 S. Ct. 16 (1944), that is entitled to appropriate respect and because of the policy favoring finality of judgments. *See Nestle Co. v. Chester's Market*, 756 F.2d 280, 282 (2d Cir. 1985).

In another case, we noted that "absent evidence of collusion, judicial [consent] decrees disposing of issues in active litigation cannot be treated as idle ceremonies without denigrating the judicial process." *Wallace Clark*, 532 F.2d at 849. In this case, Rothenberg argues that the district court lacked subject matter jurisdiction to enter the consent judgment because there was no case or controversy between the parties when the judgment was entered. We disagree.

We have no quarrel with the general rule that " 'when the issues presented are no longer "live" or the parties lack a legally cognizable interest in the outcome' ", *Murphy v. Hunt*, 455 U.S. 478, 481, 102 S. Ct. 1181, 1183 (1982) (citations omitted), the case is moot and therefore nonjusticiable. *See Babbitt v. United Farm Workers National Union*, 442 U.S. 289, 304-05, 99 S. Ct. 2301, 2312 (1979) (where a sufficiently real and concrete dispute is not presented, district court may not consider the claim);

SEC v. Randolph, 736 F.2d 525, 528 (9th Cir. 1984) (existence of a case or controversy is a threshold requirement for jurisdiction).

The fact that the parties have arrived at a settlement agreement, however, does not lead inevitably to the conclusion that no controversy exists between the parties up to the time the judgment is entered. *Id.* Where the consent judgment provides for prospective injunctive relief, the case does not become moot prior to entry of the decree. *Id.* (citing *Swift & Co. v. United States*, 276 U.S. 311, 325-26, 48 S. Ct. 311, 314-15 (1928)). In this case, one of the provisions of the consent decree "permanently enjoined [NL] from taking any steps to implement or otherwise utilize the preferred share purchase rights plan". Thus, until entry of the judgment, Amalgamated had a legally cognizable interest in securing protection against both the burdens of additional litigation and the potentially devastating financial effects of the purchase rights plan.

We find no error in the district court's rejection of Rothenberg's suggestion that NL colluded with Amalgamated in reaching the settlement agreement. Control of NL remained with the independent board of directors after Amalgamated acquired 51 percent of NL's stock; up until settlement the directors had vigorously defended the validity of the purchase rights plan, and there is every indication in the record that the settlement represented their informed judgment that the interests of NL and its shareholders would be served best by settlement.

Based on the foregoing, the district court had jurisdiction to enter the consent decree. However, that decree is res judicata as to the claim Rothenberg has attempted to assert in the state court only if there is sufficient privity

between Rothenberg and NL and its directors. The doctrine of privity, which extends the res judicata effect of a prior judgment to nonparties who are in privity with the parties to the first action, is to be applied with flexibility. *United States v. ITT Rayonier, Inc.*, 627 F.2d 996, 1003 (9th Cir. 1980). We agree with the district court that the relationship between the parties in the context of this litigation was sufficiently close to support a finding of privity and thus to preclude Rothenberg's relitigation of this issue. *See Southwest Airlines*, 546 F.2d 84, 95 & n.38 ("privity * * * represents a legal conclusion that the relationship between [the parties] is sufficiently close to [support] preclusion") (citation omitted).

As the district court concluded, there is no bright line rule as to whether or not shareholders are in privity with their corporation for res judicata purposes. Rather, a finding of privity between a shareholder and the corporation depends on whether, under the circumstances, the interests of the nonparty were adequately represented. *See Ellentuck v. Klein*, 570 F.2d 414, 425-26 (2d Cir. 1978); *Expert Electric*, 554 F.2d at 1233; *Southwest Airlines*, 546 F.2d at 95; *Alleghany Corp. v. Kirby*, 344 F.2d 571, 573-74 (2d Cir. 1965), *cert. dismissed*, 384 U.S. 28, 86 S. Ct. 1250 (1966).

In *Expert Electric*, we concluded that "one whose interests were adequately represented by another vested with the authority of representation is bound by the judgment". 554 F.2d at 1233. In that case, we held that individual electrical contractors were bound by a judgment entered against the representative association where the contractors' interests were advanced by the association in the earlier litigation. *See id.* at 1234. *See also Southwest Airlines*, 546 F.2d at 98 (airline adequately

represented by city where, in earlier litigation, government represented the only legal interests airline had in enforcing ordinance). A board of directors is vested with the authority to manage the affairs of the corporation, *see, e.g.*, N.J. Stat. Ann. § 14A: 6-1 (West Supp. 1986), and thereby represents the shareholders' interests in the corporation.

In *Alleghany Corp. v. Kirby*, where we refused to allow shareholders to intervene in a litigation after the board of directors voted not to authorize a petition for a writ of certiorari, we concluded that, absent bad faith, collusion, or negligence, shareholders may not intervene as of right "in order to continue litigation that independent [board] members, acting in good faith and in the exercise of sound business judgment, have decided to terminate." 344 F.2d at 573. We noted further that the "fact that a particular decision is adverse to certain interests does not necessarily mean those interests were not adequately represented in the decisionmaking process". *Id.* at 574. *See Southwest Airlines*, 546 F.2d at 100 (individual pecuniary interest alone insufficient to justify relitigation).

The Supreme Court has stated that collateral estoppel can be applied to nonparties where the litigating party acted in a fiduciary capacity in protecting the nonparties' interest. *Sea-Land Services, Inc. v. Gaudet*, 414 U.S. 573, 593, 94 S. Ct. 806, 819, *rehearing denied*, 415 U.S. 986, 94 S. Ct. 1582 (1974). In this case the board of directors acted in its fiduciary capacity when it represented the shareholders' interests in the validity of the purchase rights plan. Since the distinction between collateral estoppel (issue preclusion) and res judicata (claim preclusion) is not important in this case, where the issue—the validity of the purchase rights plan—and the claim—seeking a

declaration of that validity—are nearly identical, we find *Sea-Land* to be strong authority for finding privity in this case. Furthermore, the NL board members acted within their fiduciary capacity, as required by *Expert Electric*, *supra*, and Rothenberg may not opt now to relitigate the validity of the purchase rights plan after he failed to intervene earlier, merely because he claims to have an interest that was abridged by the consent decree. *See Alleghany*, 344 F.2d at 574.

"The question whether a party's interests in a case are virtually representative of the interest of a nonparty is one of fact for the trial court." *Aerojet-General Corporation v. Askew*, 511 F.2d 710, 719 (5th Cir.), *cert. denied*, 423 U.S. 908, 96 S. Ct. 210 (1975). In this case, the district judge was thoroughly familiar with every phase of the extensive proceeding that led to entry of the consent judgment. His finding that "Mr. Rothenberg had no interest in the rights plan which could be presented to the court in New Jersey that was not presented * * * by * * * NL and its directors", and that, therefore, an injunction against relitigation by Rothenberg should issue, was not clearly erroneous. *See Bechtel Petroleum, Inc. v. Webster*, 796 F.2d 252, 253 and n.2 (9th Cir. 1986) (noting that district judge who presided over earlier litigation was in best position to assess relitigation allegation), *cert. dismissed*, 107 S. Ct. 1278 (1987). Because the elements of res judicata were satisfied, the district court properly granted the injunction.

This was not a case where the district court should have abstained, either from adjudicating the merits of the purchase rights plan, or from enjoining Rothenberg's relitigation of that issue. It is well-established that a federal court exercising diversity jurisdiction need not

refrain from deciding questions of state law, *see McNeese v. Board of Ed. for Community Unit School Dist. 187*, 373 U.S. 668, 673 n.5, 88 S. Ct. 1433, 1436 n.5, (1963); *Williams v. Green Bay & W.R. Co.*, 326 U.S. 549, 553-54, 66 S. Ct. 284, 286 (1945) (citing *Meredith v. Winter Haven*, 320 U.S. 228, 234, 264 S. Ct. 7, 10, 11 (1943)); *Middle Atlantic Utilities Co. v. S.M.W. Development Corp.*, 392 F.2d 380, 386 (2d Cir. 1968), even where the corporate law of another state, 326 U.S. at 553, 66 S. Ct. at 286, or complex questions of unsettled state law, *id.*, 66 S. Ct. at 286; 320 U.S. at 234, 64 S. Ct. at 11; 392 F.2d at 386, are involved.

After the district court adjudicated the merits of the purchase rights plan prior to granting the preliminary injunction, and entered a final consent judgment incorporating the terms of the parties' settlement agreement, it was not required to abstain on principles of comity from issuing the injunction against relitigation by Rothenberg in the state court. Where a state court has not ruled on the merits of the res judicata claim, the district court may enter an injunction pursuant to the relitigation exception in § 2283. *Parsons Steel v. First Alabama Bank*, 474 U.S. 518, ____, 106 S. Ct. 768, 772 (1986). *Cf. Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519, 1527 (1987) (describing conditions implicating an "important state interest" justifying abstention). In this case, the New Jersey court had not yet ruled on the merits of the res judicata defense raised by Amalgamated, but had indicated that it would consider the merits of the res judicata defense only in the context of a full trial on the merits of Rothenberg's claim regarding the validity of the purchase rights plan. In short, because the New Jersey court had not entered a prior final judgment on the merits, but had merely denied

the summary judgment motion without prejudice, the district court was not required to abstain from issuing the injunction.

Amalgamated acted properly in moving for summary judgment on res judicata grounds in the New Jersey court prior to seeking injunctive relief in the district court, thereby attempting to avoid invoking the more intrusive remedy of injunctive relief. Rothenberg's argument that, by so proceeding, Amalgamated waived its rights to seek injunctive relief in the federal court is without merit. *See Samuel C. Ennis & Co.*, 542 F.2d 45, 48 (7th Cir. 1976) (rejecting claim that, by filing motion to dismiss in state court and waiting one year before seeking injunction, appellants had waived right to federal relief where there was no indication of "intent to relinquish" federal right and no reasonable and detrimental reliance by appellees).

The only suggestion of waiver that occurred in this case can be attributed to Rothenberg, who, although he monitored the federal litigation closely, chose not to intervene in the litigation of the merits of the purchase rights plan, apparently because he refused to concede the federal court's competence to decide questions arising under state law. *Cf. Silcox v. United Trucking Co.*, 687 F.2d 848, 852 (6th Cir. 1982) (where a party fails to take full advantage of an opportunity to litigate, he may not complain that the matter was not fully litigated). In *Silcox*, the appellant litigated in the district court, failed to appeal an adverse decision, and sought to relitigate in state court. *Id.* Although Rothenberg was not a party in the district court, he was adequately represented; if he believed that he was not he should have sought to intervene. Policies favoring the finality of judgments, judicial economy, and repose for the parties would be violated if individual

shareholders were permitted successive individual claims after those claims had been fully litigated by a board of directors acting for the best interests of the corporation in compliance with their fiduciary duties.

Since the district court's order was fully supportable on the basis of the final consent decree, there is no need to consider the interesting argument based on Judge Friendly's decision in *Lummus Co. v. Commonwealth Oil Refining Co.*, 297 F.2d 80 (2d Cir. 1961), that the preliminary injunction could form the basis for applying res judicata. On that issue we express no opinion. The order of the district court is affirmed.